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WHITE COLLAR CRIME
(E.F. Hutton)

HEARINGS

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

OVERSIGHT OF THE PROBLEM OF WHITE COLLAR CRIME

APRIL 17 AND MAY 8, 1986

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WHITE COLLAR CRIME—PART 3
(E.F. Hutton)

THURSDAY, APRIL 17, 1986

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 2 p.m., in room SD-226, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Also present: Senators Hatch, McConnell, Biden, and Metzenbaum.

Staff present: Michael Regan, staff counsel; G. Robert Blakey, minority special counsel; Lisa DeFusco, minority staff assistant; and Randall Rader, chief counsel for the Constitution Subcommittee.

OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The CHAIRMAN. The committee will come to order.

The committee continues the series of hearings on white collar crime today, as our focus turns to the Justice Department Investigation of E.F. Hutton. The investigation began in 1981 and culminated on May 2, 1985, with a guilty plea to 2,000 counts of mail and wire fraud, payment of $750,000 in investigative costs, requirement that E.F. Hutton make full restitution plus interest to the defrauded banks, and a civil injunction prohibiting numerous cash concentration practices commonly employed by E.F. Hutton.

This was an extraordinarily complex case, and it has been the subject of some controversy and substantial misunderstanding. This committee is interested in gaining insight into the investigation in order to facilitate our own appreciation of the intricacy and subtlety of schemes to defraud. The prosecutors in this case faced the difficulty of attempting to indict for crimes that were not clearly spelled out in the law, and, when measured against this disability, the pleas and injunction entered into represent a great success. However, I firmly believe that our law enforcement agencies should have adequate tools to deter crime and pursue criminals. One of the express purposes of the hearing on white collar crime is to identify inadequacies in current law and correct them.

Today the committee will have the first of two hearings on the E.F. Hutton investigation. Appearing before the committee are Stephen S. Trott and Albert Murray from the Justice Department; Robert Fomon and Robert Rittereiser from E.F. Hutton; and George Ball, formerly of E.F. Hutton, now with Prudential Bache.

I look forward to the testimony of these distinguished witnesses.

I would ask unanimous consent to enter Senator Grassley's statement into the record.

[Statement follows:]

PREPARED STATEMENT OF SENATOR CHARLES E. GRASSLEY

Mr. Chairman: I want to thank you for convening these hearings to discuss white collar crime in the cash management area and specifically the recent E.F. Hutton case.

In the past several months, considerable debate has surrounded the E.F. Hutton case with criticisms aimed at both the Justice Department's handling of the case as well as E.F. Hutton's attitude that its illegal activities were merely "creative and aggressive" ways of doing business.

Mr. Chairman, I believe there are several issues that are important for us to explore in these hearings:

(1) To what extent are corporate programs which are termed "profit-maximizing" actually fraud maximizing?

(2) What is the practical effect of prosecuting a corporation in a widespread fraud scheme, but failing to penalize any individuals?

(3) And, is our Justice Department equipped to handle complex fraud cases of this type in an effective manner?

I think it should be noted too that despite all the criticism aimed at the Justice Department's activities in the E.F. Hutton case, in the scheme of things that case may actually be one of the better efforts in terms of results. By that I mean that at least the investigation led to a tangible result. As we have already heard in some of our past hearings, many, many white collar crime cases "die on the vine" for whatever reasons. And of course an unknown number of cases go undetected.

Mr. Chairman, I believe part of the Committee's purpose in this whole series of hearings is to try and better understand the problem of white-collar crime, to get a grasp of the problem's proportions. Additionally our efforts in these hearings should be to assess the effectiveness of our current enforcement operation. I think it is appropriate to examine the E.F. Hutton case in that effort and I look forward to today's testimony.

Thank you Mr. Chairman.

The **CHAIRMAN**. Now, our first witnesses are Hon. Stephen S. Trott, Assistant Attorney General, U.S. Department of Justice; and Albert Murray, Assistant U.S. Attorney, U.S. Department of Justice.

The distinguished Senator from Ohio, Senator Metzenbaum.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator **METZENBAUM**. This case represents one of the best examples of why the people of the United States worry about equal justice. They have difficulty in understanding why a large corporation can write checks without having money in the bank and they cannot.

E.F. Hutton engaged in a check kiting scheme. That seems to be a totally accepted fact. Writing overdrafts on their checking account to earn interest to the tune of $10 billion, the company made millions of dollars in interest. The conduct took place in dozens of branch offices all over the country. There were memos to and from the highest offices in the corporation referring to making money on writing overdrafts, yet not a single individual was prosecuted. Why? Nobody seemed to have an adequate answer for that, and when we asked the Department of Justice, we get gobbledygook. We get conversation. We get sweet talk.

But how does it happen? I just talked to some steelworkers, and I looked at one of them in the audience and told him I was coming over to this hearing. And I said if you wrote a check for $250 and you did not have any money in the bank, you would wind up in the slammer. But at E.F. Hutton, with all the resources in the Department of Justice, we could not find a way to prosecute one single individual.

Talk about equal treatment. When an ordinary citizen can suffer enormous consequences from writing a check but no single individual in the corporate structure suffers any penalties, and there is $10 billion of checks. It is extremely difficult to believe that no responsible official at Hutton had direct knowledge of what was going on. It is just not believable.

The Justice Department says it had to give immunity to some persons in order to get testimony, and that is understandable. But the theory of granting immunity is to give immunity to lower level employees to obtain proof against the higher-ups. Why did that not happen here?

Far too often we hear the argument that it was not worth going after the individuals; it would have been more difficult to make a settlement. We could not have brought the thing to a conclusion, or there was no certainty of conviction, or the individuals have suffered enough because of publicity—and on and on.

No individual suffered anything in the *E.F. Hutton* case. No individual suffered anything. There are some questions that I have to ask about the severance arrangements with respect to one individual who was directly involved, to the best of my information at this moment, received something like $600,000 severance pay. I have some questions about that.

The hard reality is that corporations only engage in improper conduct because individuals make the decisions. And only when we get to the point of punishing individuals in appropriate cases can we create an environment where these individuals know it does not pay to engage in illegal shortcuts. Only by our willingness to prosecute high level corporate officials when they have engaged in illegal behavior can the American people have faith in the judicial system.

Thank you.

The Chairman. The distinguished Senator from Delaware, Mr. Biden.

OPENING STATEMENT OF SENATOR JOSEPH R. BIDEN, JR.

Senator Biden. Thank you very much, Mr. Chairman.

It is good to see you again, gentlemen.

Mr. Chairman, I have a relatively brief opening statement and then a number of questions when my opportunity comes.

Mr. Chairman, this afternoon, to state the obvious, we are continuing our hearings into the white-collar crime issue, the economic impact of which the Attorney General's annual report—admittedly as imperfect as it may be, and they do not hold it to precisely this number—that put in the $200 billion per year range, the amount of illegal revenue obtained as a consequence of white-collar crime, which I might note for the record is at a higher value than estimates for drug trafficking in this country. But not only that, the economic costs are only one part of the substantial adverse impact of white-collar crime on our Nation. Far more significant is the loss of the most precious of commodities in a free society: trust, particularly in the securities market, the subject of today's hearing.

The growth of the securities market in the United States in recent years has been little less than remarkable. From 1977 through 1983, for example, the number of shares annually traded on the New York Stock Exchange has increased from 5.2 to 21.6 billion, a net increase of over 300 percent. In addition, the number of first-time registrants with the Securities and Exchange Commission increased 260 percent. Broker-dealer registration grew by 59 percent; investment company registration grew by 52 percent. The stock market itself is now in one of its alltime high bull markets with the Dow Jones Industrial average over 1800, and I would not be surprised to pick up the newspaper tonight and find it broke 19, although I have no money in the stock market. I wish I did.

In the context of such impressive data, no argument need be advanced for the vital character of the securities market for the economic vitaility of our Nation or the economical personal welfare, security or quality of life for its citizens. But what is not often pointed out is that the whole free enterprise system of our Nation's economic life rests on an intangible foundation: trust, a trust for which there is no foolproof guarantee of permanency.

Without trust, people could not delegate the discretionary use of their funds to others. Money need only have to be kept under a mattress, not saved in banks or invested in the creation of new jobs and products, which would be a disaster for us all. Lawyers would have to become mining engineers to invest in gold. University scholars in the humanities would have to audit books themselves to invest their school's endowments. Individuals would have to create their own saving plans. I could give you 100 other examples as to why the trust is so important.

Numerous professions are employed in a close working relationship with our economic system: auditors are obviously a part of that; securities analysts and broker dealers from whom we buy and sell equity ownership in the wealth of this Nation. When one major company in that securities industry betrays the trust placed in it by other segments of our financial system, it affects more than the individuals and organizations immediately involved. It affects all of us. It calls into question the very premise upon which the economic system rests.

Mr. Chairman, the calling to account of that betrayal of trust in the private sector potentially raises another kind of trust—trust in Government, a kind of trust that is equally necessary to the working of a free society. Nothing will more surely or more quickly undermine the legitimacy of a system of Government more than the belief, well founded or not, among its people that two standards of justice are being enforced in this land: one for the high and mighty, and the other for the lowly and powerless.

The law, and those who enforce it, must be above partisan politics or narrow personal interest; it must be administered impartially by, admittedly, partisans; it must be vigorously but fairly administered without regard to the status of persons, to state the obvious. Yet recent surveys of public opinion reported in the New York Times in fact reveal that a tragic 85 percent of the American people believe that most white-collar offenders may get away with their violation. That is in the New York Times of June 9, 1985. Similarly, 68 percent of our people believe that the government is not making enough of an effort to bring white-collar offenders to the bar of justice. Those beliefs are tragic, even in fact, as I believe they are, based upon in large part mistaken facts. But either way, we must give our people good reason to change their minds.

We need to take stock of where we have been and where we are going in our enforcement efforts against white-collar crime. But one thing is certain at the outset: The recent series of white-collar crime prosecutions in the Department of Justice has produced a public reaction that something is terribly wrong.

People believe that our system of law and those who manage it have failed and may not have even tried to deal effectively with unethical or illegal conduct in high places, a view that I do not share but the American people apparently believe:

That the Government has been shortchanged and cheated on vital defense contracts—a view that I do share and believe it is also a shared view by the American people;

That fiduciaries we trust for investment advice have made fast bucks for themselves in the clandestine manipulation of the banking system's inevitable delays;

That while prosecutions have been brought, those responsible but higher up in corrupt organizations have not been appropriately held accountable—a view that I am not at all certain of but one that in fact I think is the exception;

That we do not have laws that adequately sanction such illegal conduct or serve to prevent the recurrence of it in larger organizations.

The public perceptions are certainly not totally without justification. Even from a more cautious legal or legislative point of view, the outcomes of these prosecutions raise a number of pressing questions that must be answered in this hearing today and in the months ahead.

First, do these prosecutions represent aberrations or a pattern from which we may draw more troubling conclusions?

If a pattern, is corporate wrongdoing widespread?

Are the people investigating the wrongdoing competent in fully implementing the laws that are at their disposal?

If so, are they being permitted to do their jobs?

And do they have the legal tools necessary to get the job done?

As I said at the outset of these hearings, I think it is important that we deal with the perceptions; that in fact we are not being tough enough on white-collar crime. It may very well be that the answer lies not in that we have failed to move, not in that we have lacked due diligence or competence to proceed under the laws, but that the laws we have are not sufficient to enable you to go do what the public at this point perceives we should do.

And so it is in that spirit that these hearings are one in a continuation of a series of hearings we will be holding, and I have a number of questions at the appropriate time, Mr. Chairman, to pursue, at least in this one Senator's perspective, answers to those questions—not merely whether or not the E.F. Hutton matter and affair was properly and fully prosecuted.

With that, Mr. Chairman, I have no further statement, and I will proceed in any way you think is appropriate.

The CHAIRMAN. Thank you, Senator.

Will the following witnesses please stand and be sworn: Stephen S. Trott, Assistant Attorney General; Albert Murray, Assistant U.S. Attorney; the panel of Robert Fomon, Chairman of the Board, Robert Ritterreiser——

Mr. TROTT. Mr. Chairman, with your permission, I have two other witnesses with me who will be available to answer questions.

The CHAIRMAN. Who are they?

Mr. TROTT. Robert Ogren and Peter Clark.

The CHAIRMAN. You can stand too, and I will swear all of you at once.

And Mr. Robert Ritterreiser, President of E. F. Hutton.

Please raise your right hands and be sworn. Will the testimony you give in this hearing be the truth, the whole truth and nothing but the truth, so help you God.

Mr. TROTT. Yes.

Mr. MURRAY. Yes.

Mr. FOMON. Yes.

Mr. RITTERREISER. Yes.

Mr. OGREN. Yes.

Mr. CLARK. Yes.

The CHAIRMAN. The first witness is Mr. Trott. Mr. Trott, I have just a few questions and then we will move on.

Did you want to make a statement to begin with?

TESTIMONY OF PANEL CONSISTING OF STEPHEN S. TROTT, ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE; ALBERT MURRAY, ASSISTANT U.S. ATTORNEY, U.S. DEPARTMENT OF JUSTICE, ACCOMPANIED BY ROBERT W. OGREN, FRAUD SECTION CHIEF AND PETER B. CLARK, CRIMINAL DIVISION, FRAUD SECTION

Mr. TROTT. Yes, Mr. Chairman. With your permission, I have a full statement which I would like entered into the record, if that is proper.

The CHAIRMAN. Without objection, I will put your full statement in the record. If you could just summarize it briefly.

Mr. TROTT. Yes. I have no more than 5 minutes of comments.

Mr. Chairman, as you have noted in your opening statement, the facts of the Hutton case are enormously complex. Most public comments on the results of this case have been based on a serious misunderstanding of the unusual factual and legal setting of the case and, really, in my view, a failure to appreciate the litigation risks involved in this prosecution.

Not everyone who has commented on the Hutton prosecution has made the difficult effort to learn what really happened. We are heartened, however, that the results in this prosecution has not gone unnoticed by the many regulators, bankers, lawyers, and responsible corporate managers who have taken the time to study this case. In that regard, I am very pleased to be here with Mr. Murray, Mr. Ogren, and Mr. Clark, our career people who know as much about it, along with John Holland from the Postal Inspection Service, as anybody in the country.

The Hutton prosecution is really without precedent in the Federal system. When this investigation was commenced by Al Murray and the Postal Inspection Service in Pennsylvania a number of years ago, they literally walked out onto a planet, onto terrain previously unexplored by Federal law enforcement agencies: the alien and arcane land of corporate money management.

Some of the practices embraced by our enforcement action were probably legal until the Bank Fraud statute was enacted in October 1984 as part of the comprehensive crime program. I am very pleased to say that many of the problems we had in this case were fixed by the enactment of those laws. Nonetheless, these abuses were very serious and threatened to inflict significant losses on banks.

The investigation about which we are talking essentially covered 3 years and involved ultimately the analysis of 7 million documents. On top of these difficulties, we recognized that many of Hutton's most serious cash management abuses simply could not be reached by convential criminal prosecution. Our prosecutors faced a difficult choice, Senators. In the first option, a prosecution, conventional in its scope and description of Hutton and two midlevel individuals. Such a prosecution in the judgment of our people would have been costly, inefficient, had a questionable prospect of success, and could not reach the most widespread abuses of Hutton and the rest of the money management community. The second option: a comprehensive settlement that we judged would address most directly the serious problem of widespread money management abuses in such a way that it would almost instantaneously, in connection with the money management industry, restore the trust that Senator Biden has referred to in his opening statement that is so essential to the continuing functioning of the financial institutions that were involved in this.

For what amounted to deceiving banks into giving it interest-free, unsecured, short-term loans, Hutton was required to plead guilty to an unprecedented 2,000 felony counts of intentional mail and wire fraud. It was fined $2 million, the maximum the law allowed for this unparalleled number of counts, and a sum that made it the steepest fine in the history of our white collar crime enforcement effort. Hutton was also required to pay to the Government $750,000 to cover the costs of investigation. These costs are ordinarily not recoverable, even with a jury verdict of guilty. Additionally, and in many ways most significantly, the new injunctive provision of 18 U.S.C. 1345 was used for the first time since its enactment by Congress in October 1984 to enjoin all of Hutton's cash management abuses, not just those precisely identified in the criminal information, many of which were not criminal prior to the enactment of the Comprehensive Crime Control Act.

The Department of Justice also required that Hutton immediately make full and complete restitution, with interest, to each and every one of the bank victims without regard to the Federal district in which they were domiciled. Although not required to participate in the restitution procedure, many of the affected banks by now have filed claims. Thirty claims have been settled, and I understand that Hutton and a number of banks are in the process of resolving the remaining claims. Hutton is obligated to pay back the total amount obtained fraudulently, plus interest, whatever that may be. In sum, from our view, this may be one of the most comprehensive programs of restitution for victims ever developed in a Federal criminal case—something to us that was very important. Ordinarily the concerns of the victims, the persons who lost money, are attended to after all is said and done. We made sure that in our settlement of this case each and every victim would be paid back, plus interest, as soon as possible.

As we have noted during the course of these hearings, one of the most important priorities of the Department of Justice is the protection of the banking industry, one of the arteries of our economy, from fraudulent schemes. Predatory money management practices and cash concentration systems in the hands of a few can become a science that can threaten our banking institutions. Professionals working in that specialty have associations which sponsor conferences, exchange information and publish articles. Their sophisticated activities and techniques have a substantial impact on our Nation's banks and financial institutions of which few people are aware. Hutton's practices had tremendous potential for harming banks, particularly the smaller, more vulnerable ones. The injunction forged in this case covers conduct that we were unable to include in our criminal charging document because of deficiencies in the law; thus, we achieved important multiple objectives in a single, decisive stroke. This conviction and injunction sent a clear message to professional money managers around the country: There should be no doubt that these kinds of abuses are criminal and now will be vigorously prosecuted.

In assessing the manner in which this case ought to be handled, our prosecutors started, our prosecutors commenced from the proposition that individuals ought to be held personally responsible for their criminal misconduct. Senator Metzenbaum is accurate in his observation this is the backbone of our enforcement effort. This is the normal policy from which we deviate only when faced with a compelling reason to make an exception. Pursuing at trial the known individual authors of these abuses would have had some merit, but not at the expense, in our judgment, of foregoing the opportunity to dictate the key terms of, and seize without delay, the benefits of this extraordinary settlement. To prosecute the individuals would have required us to drop the settlement in favor of a protracted court fight that would have taken years to complete. That was the choice. Our career prosecutors opted for the numerous overwhelming benefits of the immediate solution, and we find their judgment to be absolutely sound and above reproach.

There is no doubt that our assessment of the need for immediate action was correct. The Chairman of the Federal Reserve Board noted the influence of the Hutton prosecution and the unexpected $1 billion jump in M1 in May 1985. Trade journals and professional publications have now trumpeted the warning that cash management abuses must be stopped or they will be prosecuted. The threat that Hutton-type cash management abuses posed for the banking system is less today because of our enforcement action.

Mr. Chairman, I believe that time might be best served at this point in turning the microphone over to Al Murray who is the unusual career prosecutor who had the courage, the determination, and the gumption to take this case from the single incident that it was, to view it as something that had the possibility of national implications, and to spend 3 years developing it into what we consider at the Department one of the most significant white collar prosecutions we have ever had. From the Department of Justice, we view this effort such that Mr. Murray is going to receive an award for his efforts in this case. That is the way we view it.

With your permission, if I may turn the microphone over to Mr. Murray.

[Statement follows:]

Department of Justice

STATEMENT

OF

STEPHEN S. TROTT
ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

BEFORE

THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

CONCERNING

WHITE COLLAR CRIME

ON

APRIL 17, 1986

I appreciate this opportunity to present our views on the E.F. Hutton prosecution and the directly related problem of fraud against financial institutions.

On February 27, 1986, in testimony before this Committee, Deputy Attorney General D. Lowell Jensen restated the commitment of the Department of Justice to a vigorous federal white collar crime enforcement program. These Hearings are occurring in the wake of a series of landmark events in white collar crime enforcement and at a time when the importance of effective federal white collar crime enforcement is more critical than ever.

The key to the federal white collar crime enforcement effort is to use our resources as efficiently and effectively as possible. This requires our selecting priorities with care, developing close cooperation among all elements of law enforcement, crafting creative strategies and carefully utilizing our resources in the most effective manner.

As Deputy Attorney General Jensen testified on February 27, 1986, one of the Economic Crime Council's principal roles has been to aid in developing white collar crime priorities. The Council, working in conjunction with the Criminal Division, has defined our law enforcement priorities sharply and clearly. We are all concerned about the areas that affect our national defense, our banking system, the taxpayer and the investment public. The six principal priority areas on which we have agreed to focus our efforts are defense procurement frauds, frauds against banks and savings and loans, investment "boiler room" frauds, money laundering, various types of securities frauds and health care frauds. We must strike decisively and effectively against these economic crimes lest they corrupt the economic integrity of our society and its institutions.

One priority area of prosecution -- bank fraud -- is of particular relevance to today's hearings. Fraud against banks and other financial institutions is a major concern of the Department of Justice for one simple reason. Over one half of the bank failures in the United States in the last five years were either caused by or related to criminal conduct. That fact is deeply disturbing. The nation's economic health rests upon stability and public trust in our banking institutions. With this objective in mind, former Attorney General Smith and the heads of the bank regulatory agencies created a task force in December 1984 to revise the referral mechanism that brings bank fraud cases into the criminal justice system and to improve the handling of major bank fraud cases. The result of that effort, announced by Attorney General Meese a year ago, is an interagency agreement which has already improved our capacity to handle the criminal prosecution of significant bank fraud cases. One specific objective of the task force -- and one relevant to these hearings -- was to improve the enforcement mechanism so that enforcement action could be taken before banks failed as a result of criminal conduct.

Before turning to the specific facts of the Hutton case, I want to address briefly another point.

We believe there are a number of ingredients to a successful criminal enforcement effort. Certainly the dominant one is the prosecution, conviction and imprisonment of all individuals who perpetrate crime. But that traditional solution, appropriate in many instances, sometimes does not go far enough. It does not take into account the need to prevent crimes before they occur, or to bring cases which by their novelty, scope and the swiftness by which they become final, provide clear, dramatic warning that specific conduct will be prosecuted. It also ignores the need, in the very special setting of offenses committed to benefit corporations, to impose direct and substantial sanctions upon these corporations, in addition to those imposed on individuals, and to force the corporations to adopt internal control mechanisms that will prevent future criminal conduct and substantially alter the ways in which corporations conduct their affairs.

We are proud of our record and, with respect to the subject matter of today's hearing, we are proud of the results achieved in the E.F. Hutton prosecution. It should be remembered that the Hutton case was but one of hundreds of noteworthy white collar crime prosecutions brought in 1985. However, by any standard, the Hutton case is a landmark and its law enforcement accomplishments are noteworthy.

The facts of the Hutton case are enormously complex. Most public comment on the results in the case has been based both on a serious misunderstanding of the unusual factual and legal setting of the case and a failure to appreciate the litigation risks faced in the prosecution. Not everyone who has commented on the Hutton prosecution has made the effort to learn what really happened. We are heartened, however, that the results in this prosecution has not gone unnoticed by the many regulators, bankers, lawyers and responsible corporate managers who have taken the time to study the case. The message of the Hutton case has been read loud and clear by those immediately affected by it. To aid your understanding, I am appending to this statement a summary of the Hutton case, which includes a description of its legal setting, the litigation risks we confronted and the relief we obtained.

The Hutton prosecution is without precedent in the federal system. Some of the practices embraced by our enforcement action were probably legal until enactment of the bank fraud statute in October 1984. Nevertheless, they constituted serious abuses that threatened to inflict significant losses on banks. The perpetrators did not believe they were committing a crime, although in fact their acts now, as a result of the swift resolution in the Hutton case, are widely known in the cash management community to be clearly illegal. The investigation covered three years and ultimately involved the analysis of 7,000,000 documents. On top of these difficulties, we recognized that many of Hutton's most serious cash management abuses could not be reached by a conventional criminal prosecution.

Our prosecutors faced a difficult choice. The first option: a conventional prosecution of Hutton and two mid-level individuals, would have been costly, inefficient, had a questionable prospect of success and could not reach the most widespread abuses of Hutton and the rest of the money management community. The second option: a comprehensive settlement that we judged would address most directly the serious problem of widespread money management abuses.

For what amounted to deceiving banks into giving it interest-free unsecured short-term loans, Hutton was required to plead guilty -- not nolo contendre but guilty -- to an unprecedented 2,000 felony counts of intentional mail and wire fraud. It was fined $2,000,000, the maximum the law allows for this unparalleled number of counts, and a sum which makes it the steepest fine in the history of our white collar enforcement effort. Hutton was also required to pay the Government $750,000 to cover the costs of the investigation. Those costs are ordinarily not recoverable, even with a jury verdict of guilty. Additionally, and in many ways most significantly, the new injunctive provision of 18 U.S.C. §1345 was used for the first time since its enactment by Congress in October, 1984, to enjoin all of Hutton's cash management abuses, not just those precisely identified in the criminal information, many of which were not criminal prior to enactment of the Comprehensive Crime Contract Act.

The Department of Justice also required that Hutton immediately make full and complete restitution, with interest, to each and every one of the bank victims without regard to the federal district in which they are domiciled. Although not required to participate in the restitution procedure, many of the affected banks have filed claims. Thirty claims have been settled and I understand that Hutton and a number of banks are in the process of resolving the remaining claims. Should those negotiations fail, the Court appointed Special Master will make the final decisions. Rarely is there a criminal fraud case where we can secure these benefits for the victims. Hutton is obligated to pay back the total amount obtained fraudulently, plus interest, whatever that may be. In sum, this is one of the most comprehensive programs of restitution ever developed in a federal criminal case.

As I noted before, one of the important priorities of the Department of Justice is the protection of the banking industry itself from fraudulent schemes. Predatory money-management practices and cash concentration systems have become, in the hands of a few, a science that can threaten our banking institutions. Professionals working in that specialty have associations which sponsor conferences, exchange information and publish articles. Their sophisticated activities and techniques have a substantial impact on our nation's banks and financial institutions of which few people are aware. The Federal Reserve has been highly critical of "float creating" and "float-playing games," of which Hutton's was an extreme example, and we are in agreement with that concern. Hutton's practices had tremendous potential for harming banks, particularly the smaller, more vulnerable ones. The injunction covers conduct that we were unable to include in our criminal charging document and thus we achieved important multiple objectives in a single decisive stroke. This conviction and injunction sent a clear message to professional money managers around the country. There should be no doubt that these kinds of abuses are criminal and will be prosecuted.

The public must have faith in the stability of our financial institutions, and they must have it today, not tomorrow. By naming the numerous small banks victimized by Hutton in an unresolved indictment and alleging widespread fraud and losses we ran the substantial risk of undermining public confidence in those banks. If that route had been chosen and runs on deposits had developed, the situation would have been highly undesirable. One only has to look to the recent problems in Ohio and Maryland to see how fragile public confidence can be when it appears to depositors that the financial institution to whom their money has been entrusted is on shaky ground. The plea of guilty, the injunction plus complete restitution without a risky, costly and lengthy trial achieved our objectives, now, not two or three years from now. The word is out. The cloud is gone. The matter has been favorably resolved without the uncertainities and vagaries of the protracted trial which trial we estimate would have involved some 300 witnesses and several hundred thousand documents.

Several aspects of the case deserve mention. As we have described more fully in the case summary submitted with this testimony, check kiting became difficult to prosecute as a result of the Supreme Court's decision in United States v. Williams, 458 U.S. 279 (1982). The theory prosecutors traditionally employed was that an overdraft check constituted an "overvalued security" or a "false statement" to the bank which honored it. The Supreme Court rejecting that theory held that a check made no representation as to the state of the bank account on which it was drawn, and, moreover, was not an overvalued security.

As you know, we recommended remedial legislation to the Congress to cure this problem and that provision, 18 U.S.C. §1344, was adopted as part of the Comprehensive Crime Control Act of 1984.

Before passage of §1344, the principal alternative to §1014 as a check kite prosecutive vehicle was mail or wire fraud in the limited cases where those statutes applied. In the Third Circuit, however, Williams took its toll on the "mail fraud/wire fraud" approach to prosecuting check kites. In United States v. Frankel, 721 F.2d 917 (3rd Cir. 1983), the Court relied on Williams to conclude that a check kite could not be charged under the "false pretenses, representations and promises" clause of 18 U.S.C. §1341 because a check was not a representation. Frankel left open the possibility of a prosecution under the "scheme to defraud" clause, but failed to explain how that could be done.

The net effect of the Williams and Frankel decisions was to circumscribe our ability to prosecute check kites. Finding a theory that would not lead to a dismissal under either Williams or Frankel was not simple. The theory we adopted, and which is reflected in the Hutton criminal charges, focused on a Hutton's misrepresentation to its banks: Hutton held itself out as creating depository accounts to handle only customer money where in fact the accounts were used to process huge overdraft checks. This is a rather unconventional and untested prosecutive approach to check kiting and its success depended completely on our ability to establish persuasively that the depository accounts were intended for a highly specific limited use. Obviously, this creative circumvention of Williams and Frankel would have been tested vigorously pre-trial and post-conviction.

The second legal defense we expected was a claim of good faith. Hutton asserted it was guilty merely of aggressive money management. In fact, Hutton insisted that they had done nothing wrong and had only attempted to "recapture float" that did not belong to the banks. Hutton insisted that its practices were no different than those of other companies.

The third possible legal attack on our case, available to the individuals who might have been charged, was the simple claim that each was acting pursuant to corporate policy and, because Hutton had the means to pay the banks, the requisite _mens rea_ or intent to defraud was absent.

As to the individuals primarily responsible in a criminal sense for this activity, there were essentially two key people. Beyond that they cannot be identified -- nor can the evidence against them be detailed or characterized -- because of Rule 6(e) of the Federal Rules of Criminal Procedure that requires continuing secrecy with respect to matters occurring before a grand jury. However, neither individual was a high-level executive of the company.

In assessing the manner in which this case ought to be handled, our prosecutors started from the proposition that individuals ought to be held personally responsible for their criminal misconduct. This is our normal policy from which we deviate only when faced with a compelling reason to make an exception. Pursuing at trial the known individual authors of these abuses would have had some merit, but not at the expense of foregoing the opportunity to dictate the key terms of, and seize without delay the benefits of, this extraordinary settlement. To prosecute the individuals would have required us to drop the settlement in favor of a protracted court fight that would have taken years to complete. That was the choice. Our career prosecutors opted for the numerous overwhelming benefits of the immediate solution, and we find their judgment to be absolutely sound and above reproach.

There is no doubt that our assessment of the need for immediate action was correct. The Chairman of the Federal

Reserve Board has noted the influence of the Hutton prosecution in the unexpected 1 billion dollar jump in M-1 in May 1985. Trade journals and professional publications have trumpeted the warning that cash management abuses must be stopped or they will be prosecuted. The threat that Hutton-type cash management abuses posed for the banking system is substantially less today because of our enforcement action. We faced some difficult problems and difficult choices in this prosecution. We overcame the problems and, looking back, I am all the more convinced that we made the right choices.

Summary of the E.F. Hutton & Company Inc. Investigation and Prosecution

In December 1981, a check kite being operated by a number of E.F. Hutton & Company Inc. ("Hutton") branches collapsed when an $8,100,000 check was bounced by the Genessee Country Bank of Batavia, New York. This event triggered a joint inquiry by the New York State Banking Commission and the Federal Reserve Bank of New York. Ultimately an FDIC examiner learned of the incident and, because the kite involved checks drawn on the United Penn Bank in Wilkes-Barre, Pennsylvania, the examiner referred the matter in March 1982 to the United States Postal Inspection Service in Scranton, Pennsylvania, and to the United States Attorney in Scranton. Assistant United States Attorney Albert R. Murray, Jr. of the Middle District of Pennsylvania was assigned to the case.

After reviewing the allegations and events surrounding the Genessee/United Penn kite, Assistant United States Attorney Murray opened a grand jury investigation. [1/]

Staffing and Scope of the Investigation

The investigation commenced in April 1982 and continued until May 1985. Assistant United States Attorney Murray believed it possible that the Genessee kite was evidence of more wide spread abuses by Hutton. The investigation was structured to test that theory. The investigation was staffed by Assistant United States Attorney Murray and a Postal Inspection team headed by Postal Inspector John Holland of the Harrisburg office. Assistant United States Murray, who had previously been in private practice, became an Assistant United States Attorney in January 1980. Mr. Holland has been a postal inspector for 14 years. Peter B. Clark, an experienced Criminal Division Fraud Section attorney, previously in private practice and a Special Counsel in the Enforcement Division of the Securities and Exchange Commission, joined the prosecutive team in August 1984.

1/ During the grand jury investigation the Supreme Court decided United States v. Williams, 458 U.S. 279 (1982) which drastically curtailed federal prosecutions of check kiting. See discussion *infra* under "Legal Theory and Problems."

The site of the investigation, for logistical and tactical reasons, was Harrisburg, Pennsylvania. One key reason was to limit the possibility of publicity. The grand juries that investigated the Hutton matter were located in Harrisburg.

During the investigation numerous witnesses testified before the grand jury, many on more than one occasion. Many witnesses insisted upon use immunity protection, which was supplied in the form of a letter in lieu of statutory §6001 immunity. In each instance, proffers were received in advance of the immunity grant. No immunized witness was a target of the grand jury investigation.

Except for those who invoked the Fifth Amendment and refused to testify, all relevant Hutton headquarters personnel were interviewed.

John S.R. Shad, Securities and Exchange Commission Chairman, was, until 1980, vice-chairman of the board of Hutton. There was no evidence nor any allegation that Mr. Shad had participated in the check scheme or indeed knew about it. Mr. Shad was interviewed and we concluded that he had no connection with the scheme.

Over 300 subpoenas were issued during the investigation. The number of documents obtained by subpoena was approximately 7,000,000. One of the principal initial tasks was to organize the subpoenaed documents pursuant to a system that permitted orderly retrieval. The documents were physically maintained at the main postal facility in Harrisburg. Because their volume exceeded available space in the Postal Inspection Service offices, the records were maintained in a large, specially constructed, locked area of the post office basement.

A major task of the investigation was to acquire a working knowledge of Hutton's cash concentration system and the Federal Reserve and bank check collection systems. A substantial portion of the investigative effort during the first 18 months was devoted to accomplishing these objectives.

A further point should be noted. The original investigative focus was Hutton's activity within the Middle District of Pennsylvania. Until 1984, the investigation did not focus on practices and specific abuses that occurred nationally. The narrow geographic focus of the first half of the investigation was dictated by the original allegations and the venue limitations of federal criminal jurisdiction.

Once it became clear that Hutton's activities were not mere isolated episodes but appeared to reflect a widespread corporate practice, Assistant United States Attorney Murray's objective was to place responsibility for this practice at the highest possible level within Hutton. As a general rule, this strategy led to the pattern of interviewing branch personnel (most of whom sought and obtained immunity), and subsequently certain regional personnel, in an effort to build a case against the members of management responsible for devising and implementing Hutton cash concentration policies. In that regard, it is important to note that vast majority of those who sought and received "immunity" were not criminally culpable in the scheme. Informal immunity is often sought by attorneys representing non-culpable persons in an investigation.

What Hutton Did

In the late 1970's, Hutton had in place a cash concentration or "draw down" system by which the funds collected from its customers at over 400 branch offices throughout the country were moved to bank accounts in New York and Los Angeles, where the funds were available for Hutton's business uses. These customer funds, which amounted to between $200 and $400 million each business day, were first deposited in local bank accounts maintained by each Hutton branch. Hutton advised its branch depository banks were advised by Hutton that these accounts would be used to deposit funds received from the firm's local customers and to transfer these funds to Hutton's regional and prime concentration bank accounts. The local depository banks granted Hutton "next-day" availability on these deposits, that is, on the business day following the deposit of local customers' checks.

Hutton would be permitted to withdraw funds in the amount of the deposited items. The branch depository banks believed Hutton would be depositing checks Hutton had received from local Hutton customers, and that the banks would be collecting them on the following business day. Therefore, the banks assumed they would be in a collected position by the time Hutton withdrew the funds.

While Hutton could have transferred its collected or available funds from its hundreds of branch depository accounts to its prime concentration accounts by bank wire transfers, this procedure would have required over 150,000 wire transfers each year at an estimated cost in excess of $1 million. Instead, Hutton "drew down" its branch depository accounts by means of a system which, each business day, required (1) Hutton branch office personnel to determine the collected balance in each branch depository account and telephone that information to the branch's regional office; (2) Hutton regional office personnel to draw checks manually on each branch depository account in their region, deposit the checks in a regional depository account and telephone that information to the firm's cash desk in New York City; and (3) Hutton main office personnel to draw checks on each regional depository account or otherwise direct the transfer of funds from the regional depository accounts to the firm's prime concentration accounts in New York City or Los Angeles. This system, so long as only collected funds were drawn down, was legal.

Hutton's illegal conduct was a series of variations on its established "draw down" system. Hutton modified the legal draw down procedure to withdraw funds from its branch depository accounts in arbitrary amounts well in excess of either customer receipts or the collected balances in those accounts. To do this, Hutton had to "cover" or otherwise conceal the overdrafts it created by depositing into those accounts checks drawn upon other Hutton accounts. These overdrafts, in turn, were hidden from the depository banks by covering checks drafted by Hutton branch personnel and deposited into bank accounts. These checks, available in each Hutton branch office, were drawn upon "zero balance" accounts at one of two New York City banks. By agreement with these banks, Hutton was required to keep no minimum balance but rather was permitted to wire transfer into the accounts, on a daily basis, sufficient funds to cover all checks presented for collection that day.

Furthermore, the covering "zero balance" checks, unlike the local Hutton customer checks which would be collected within one day, took a minimum of two days to clear. Nevertheless, branch depository banks, not realizing that these were not deposits of local customer funds, permitted Hutton to have "next-day" availability on these items as well. Hutton thus exploited the customary bank practice of examining only the ledger balance to determine whether an overdraft exists in an account. As Hutton's branch office personnel were continually depositing Hutton's own checks into the depository accounts, these deposits appeared on the bank's ledgers to balance Hutton's withdrawals. In actuality, because of the minimum one extra day in the collection of a Hutton "zero balance" check, the account was overdrafted for an equivalent period.

Overdrafting was accomplished in a variety of ways, the most blatant being the simple addition of a "zero" to the branch depository transfer check. In this manner, a $100,000 deposit of customers' funds would be arbitrarily increased to $1 million as it was drawn down and a Hutton "zero balance" check in the amount of $900,000 would be deposited in the account to cover the overdraft.

Two specific instances of arbitrary overdrafting, drawn from the Rule 11 proceeding, show dramatically the essence and scope of the Hutton scheme. On November 2, 1981, the Hutton branch office in Williamsport, Pennsylvania deposited $92,475.12 in customer funds in its account at the Northern Central Bank in Williamsport. That day, the amount drawn down from the account into the firm's prime concentration account was $925,000. The difference, $832,524.88, was made up by a check drawn in that amount by Hutton's Williamsport branch office on the firm's zero balance account at Chemical Bank in New York City. This pattern was repeated at the Northern Central Bank throughout November 1981.

On the same day, November 2, 1981, the Hutton branch office in Alexandria, Virginia received customer funds in the amount of $70,629.46 which it deposited in its account at United Virginia Bank. The amount drawn down from the account that day was $9,953,400. The overdraft was covered with a zero balance account check. Between January and December 1981, the Hutton branch in Alexandria received a total of $33,537,397.20 in customer funds and withdrew from its depository account at United Virginia Bank some $640,796,712.08, well over one-half billion dollars in overdrafts. The average daily overdraft at this bank was approximately $9,000,000 in November 1981.

A complimentary, and more pernicious, scheme was the practice of "chaining" whereby Hutton caused funds to be transferred between various branch and regional depository bank accounts prior to deposit in a prime depository account for the purpose of providing additional points for the arbitrary increase of withdrawals and to increase the opportunity for and likelihood of delays in the clearing times of the covering "zero balance" checks.

In the course of the investigation, approximately fifty such "chains" were uncovered which operated in all parts of the country during 1981 and part of 1982. The practices of "chaining" and arbitrary overdrafting occurred principally in 1981. Within several months of the collapse of the Genessee/United Penn kite, those activities were halted.

By overdrafting as much as $250 million per day from its depository accounts, and perpetuating its overdrafts on successive days, Hutton both avoided the necessity to borrow extensive amounts of working capital and earned interest income on surplus funds.

Under one part of the plea agreement, Hutton was enjoined in the §1345 civil injunctive proceeding from engaging in two additional practices not charged in the criminal information.

The first was the use of a "draw down sheet" or formula by which Hutton sought to overdraft its depository bank accounts in an amount which it claimed compensated the firm for the weekend and holiday periods during which funds were unavailable to Hutton. The essence of the draw down sheets was a "multiplier" which increased the amount withdrawn on certain days by a factor of two, three or four.

Hutton's objective in using the draw down sheet and its multiplier was to achieve a "target" or average balance of zero in each of its branch depository bank accounts. To the extent that banks held Hutton funds on weekends or holidays, Hutton recaptured use of that money by precisely calculated overdrafts. While this conduct was not as egregious as the massive, arbitrary overdrafting exemplified by the Williamsport and Alexandria cases, the activity was far more pervasive. Unfortunately, from a criminal prosecutive standpoint, the target balancing technique may be relatively common and was certainly one not considered illegal by Hutton's employees. Without the §1345 civil injunction, the target balance activity would have continued at Hutton.

Another practice was the daily "criss-cross" of checks between two Hutton bank accounts for the purpose of inducing these banks to certify a daily opening balance in each account. Both banks were thereby induced to certify that Hutton had opening balances aggregating substantial sums when the actual aggregate balance was almost zero.

All of these activities--both the practices charged in the information and the activities prohibited in the final judgment of permanent injunction in the civil proceeding--were designed, instituted and promoted by Hutton's money management personnel. The investigation did not develop sufficient evidence to merit the prosecution of any individuals superior to these persons in the Hutton organization.

There are two primary reasons why the money management personnel, rather than senior management, were responsible for these abuses. First, the operations of a brokerage firm such as Hutton are organized into two functional areas: the "front office," which performs all the sales related activities and the "back office," which handles the paperwork generated by the front office and all of the other day-to-day operations of the firm. The registered representatives are the best compensated and are rewarded by promotion to management positions. The back office personnel, who perform the mundane, albeit, in some cases, extremely responsible, tasks are not well compensated and have virtually no opportunity to advance into the senior management levels of a brokerage firm. Senior managers, selected without exception from the ranks of the front office, have neither the experience nor inclination to become involved with back office management. Second, unlike some other major brokerage firms, Hutton's regional and branch operations were effectively "decentralized." Indeed, the regional and branch managers were encouraged to be independent; Hutton closely monitored profit and loss figures for each branch.

It was in this context that Hutton's money managers operated. It was clear from the investigation that they lacked the authority to impose uniform money management procedures throughout the Hutton branch office organization. Although various "draw down" sheets were devised and tinkered with and small meetings and seminars held at irregular intervals to encourage their use, not all branch offices followed the money management office's suggestions. One major reason was that the formula computations required to complete the draw down sheet were complicated and not every branch manager or cashier could do them. Few of the branch cashiers grasped the illegal nature of the activity which the sheets fostered. Furthermore, the evidentiary link between Hutton's money management office and the type of activity found at the Williamsport or Alexandria branch offices was tenuous. Hutton's policy of considering each branch office as an independent profit center led, inexorably, to a sharing with the branch offices of a portion of the interest income being generated by the money management techniques. Some branch office managers, whose compensation was, in part, based upon their office's profitability, were undoubtedly tempted by the opportunities for indirect personal benefit provided by the ability to engage in overdrafting of branch depository accounts. Branch office personnel, however, did not create the scheme and, except for a few instances, did not comprehend its illegality.

Legal Theory and Problems

Check kiting became extremely difficult to prosecute under federal law as a result of the Supreme Court's decision in United States v. Williams, 458 U.S. 279 (1982). The typical check kite case had been prosecuted in the federal system as a violation of 18 U.S.C. §1014. The relevant language is:

> "Whoever knowingly makes any false statement or report, or willfully overvalues any land, property or security, . . . for the purpose of influencing in any way the action of . . . any bank the deposits of which are insured by the Federal deposit Insurance Corporation . . . upon any application, advance, discount, purchase, purchase agreement, repurchase agreement, commitment, or loan, or any change or extension of any of the same, by renewal, deferment of action or otherwise, or the acceptance, release, or substitution or security therefor, shall be fined not more than $5,000 or imprisoned not more than two years, or both."

The theory employed by federal prosecutors was that a kited check was an "overvalued security" or a "false statement." The Supreme Court held, however, that a check does not "make any representations as to the state of petitioner's bank balance," 458 U.S. at 285, nor is it an overvalued security."

The consequence of Williams was to limit drastically federal law enforcement's ability to prosecute check kites. In March 1983, the Department of Justice recommended remedial legislation in the form of a comprehensive bank fraud statute. A year and one half later that statute was adopted as part of the Comprehensive Crime Control Act of 1984 and is codified at 18 U.S.C. §1344. The legislative history makes it clear that §1344 reverses Williams.

Before passage of §1344, the principal alternative to §1014 as a check kite prosecutive vehicle was mail or wire fraud in the limited cases where those statutes applied. In the Third Circuit, however, Williams, took its toll on the "mail fraud/wire fraud" approach to the prosecuting check kites. In United States

v. Frankel, 721 F.2d 917 (3rd Cir. 1983) the Court relied on Williams to conclude that a check kite could not be charged under the "false pretenses, representations and promises" clause of 18 U.S.C. §1341 because a check was not a representation. Frankel left open the possibility of a prosecution under the "scheme to defraud" clause, but failed to explain how that could be done. [2]

The net effect of the Williams and Frankel decisions was to eliminate almost completely our ability to prosecute check kites in the Third Circuit. Finding a theory that would not lead to a dismissal under either Williams or Frankel was not simple. The theory that was adopted focused on Hutton misrepresenting its relationship to the banks: Hutton held itself out as creating depository accounts to handle only customer money where in fact the accounts were used to process huge overdraft checks. This is a rather unconventional prosecutive approach to check kiting and turned completely on our ability to establish persuasively that the depository accounts were intended for a highly specific limited use. Obviously, this creative circumvention of Williams and Frankel would have been tested vigorously by a motion to dismiss.

The second legal defense we expected to face was a claim of good faith. Hutton asserted that it had done nothing wrong and was guilty merely of aggressive money management. Hutton also alleged it had merely attempted to "recapture float" that did not belong to the banks. Hutton insisted that its practices were no different than those of other companies.

The third legal attack on our case, available to the individuals who might have been charged, was the simple claim that each was acting pursuant to corporate policy and because Hutton had the means to pay the banks, the requisite mens rea was absent. It is clear that each of the few employees that might have been prosecuted firmly believed his conduct was legal.

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[2] The possibility of ITSP (18 U.S.C. §2314) remained, but only as an illusion since that statute requires proof of a fraud. The Williams and Frankel problems led again to the issue of how to define the fraud without relying on the overdraft check as a misrepresentation.

The final legal defense was essentially the caveat emptor view that since the banks in fact could observe the transactions, they acquiesced in them.

Process of Evaluation

The Criminal Division was first apprised of the Hutton investigation on March 5, 1984. In April 1984, Fraud Section Chief Robert W. Ogren met in Harrisburg, Pennsylvania with Assistant United States Attorney Murray, Inspector Holland and a number of postal inspectors. The purpose of the meeting was to explore possible theories of prosecution, assess the progress of the investigation, and assess whether staffing of the investigation was adequate.

By mid-summer, it was clear that an additional prosecutor was needed to co-counsel the case, to share the work load with Assistant United States Attorney Murray, to complete the grand jury investigation and to assist in sharpening the focus of the remainder of the investigation. Peter B. Clark of the Fraud Section of the Criminal Division was selected.

Assistant United States Attorney Murray had begun working on a draft indictment in the summer of 1984. The timetable to which the prosecutive team sought to adhere contemplated returning of an indictment in November 1984, shortly before the grand jury's term expired. Thereafter, the grand jury's term was extended for six months to May 1985 to finish the investigation and to permit thorough review of the evidence and theory of prosecution.

Simultaneously with our efforts to complete the investigation late in 1984, the various defense counsel representing Hutton and several targeted individuals sought to make presentations to United States Attorney David Dart Queen in Scranton, Pennsylvania and to the Criminal Division. Mr. Ogren responded to all requests from counsel to meet with Department officials by requiring counsel to present their positions in the first instance to the United States Attorney in Scranton. Several meetings were held in Scranton at which the prospective defendants' positions were set forth. These meetings were held in October and early November.

Counsel for Hutton then requested the opportunity to make written presentations to the Criminal Division and to make an oral presentation to Assistant Attorney General Stephen S. Trott. We agreed to review Hutton's written position and prescribed a timetable for written submissions. The written submissions, which were voluminous, were reviewed in detail. We subsequently agreed to meet with counsel and the oral presentation was scheduled and held on January 7, 1985. [3/]

In mid-January 1985, in Harrisburg, Fraud Section Chief Ogren reviewed the evidence against Hutton with Messrs. Murray, Clark and Holland. [4/] The purpose of this review was to provide a recommendation to Assistant Attorney General Trott for or against indictment of Hutton. This review led to the conclusion that criminal charges for mail and wire fraud could be brought against Hutton if the theory of prosecution was narrowly focused on the grossly excessive overdrafts and the phenomena of overdraft "chains." It was also clear that the evidence might support charging some individuals but review of that issue was temporarily deferred. Meanwhile, Mr. Ogren requested Messrs. Murray and Clark and the Postal team to develop evidence of additional chains as a priority matter. Fraud Section Chief Ogren reported his conclusions and recommendations to Mr. Trott, who in turn asked Mr. Ogren to advise Hutton's counsel that he had made a decision to proceed to indict. Mr. Ogren advised Hutton's counsel of Mr. Trott's decision.

Two weeks later, in Harrisburg, Messrs. Ogren, Murray, Clark and Holland conducted an intensive review of the evidence against target individuals. The preliminary assessment was that we had sufficient evidence to proceed against two Hutton employees. The tentative conclusion was also reached that additional evidence would be required before any other individuals could be added to

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[3/] Attending were Trott, Deputy Assistant Attorney General Victoria Toensing, Ogren, Clark, Murray, Holland and Supervising Postal Inspector Thomas Dagley, plus counsel for Hutton.

[4/] In January 1985, United States Attorney Queen resigned his office and the Fraud Section of the Criminal Division, which had been assisting in the investigation, assumed direct supervision of the matter.

the list of probable defendants. Counsel for the employees were advised of our decision and in turn they sought to make presentations on their clients' behalf. Meetings with these counsel took place in February 1985. [5/]

Assessment of Risks of Trial

A major component of the judgmental equation was the risk faced in litigating the criminal case with two or more individuals joined as defendants.

An indictment would have resembled the information, but would have been limited to counts involving jurisdictional uses only in the Middle District of Pennsylvania. The focus of an indicted case would have been on two types of check abuses: the arbitrary overdrafts exemplified by the Williamsport and Alexandria situations and branch-to-branch chains exemplified by the Genessee/United Penn kite. In order to demonstrate the breadth and significance of the scheme we expected to prove six or more arbitrary overdraft situations and at least twenty chains.

The scope and complexity a potential trial was unprecedented. Of the 7,000,000 documents subpoenaed by the grand jury, our estimate is that several hundred thousand would have been needed at trial. The number of authenticating witnesses alone would have exceeded 200.

Several hundred descriptive charts would have been required. Approximately 20 charts were prepared for use in the Rule 11 proceeding simply to explain the theory of the government's case to Chief Judge Nealon.

In addition to hundreds of authenticating witnesses, we would have presented over one hundred fact witnesses and a number of experts.

Pretrial discovery in this case would have taken months.

Although the case management problems of the prosecution

[5/] Attending for the government were Messrs. Ogren, Clark, Murray and Holland.

were enormous, and the expense of the litigation would have been considerable, other factors were of greater importance.

Put bluntly, this case was not a sure winner against individuals. The probable legal defenses mentioned above were not weak. In addition, there were a number of serious practical problems. The most significant:

- The prospective individual defendants did not gain personally from their offenses. This defense has historically been an effective one with juries. Our most recent example is the acquittal on May 10, 1985, of George McLean, a former International Harvester employee, in the Pemex FCPA prosecution.
- The banks in many instances should have uncovered the fraud. It could appear they had turned their heads to avoid discovering it (in which case it would have been argued that it was not a fraud).
- We recognized that two attitude factors might contribute to jury nullification: one might best be described as a "to hell with the banks" attitude; the second, the "there but for the grace of God go I" attitude reflecting the reality that, at one time or another, most jurors have overdrawn their accounts. These two attitudes, coupled with a defendant's demonstrable ability to pay, have historically made check kite and bad check cases extremely difficult to prosecute successfully.
- Severance problems. In all likelihood, one individual defendant would have been entitled to a severance. Thus the case would have been tried twice.
- Confusion. Although, we believe the clarification of the theory of prosecution and limitation of the proof to arbitrary overdrafts and chains was constructive, the government's evidence was complex and difficult to understand. It is noteworthy that after several weeks of our providing detailed briefings and answering questions for Congress and the Press, only a handful of the

reporters and political figures who have written or commented on the case appear to have any idea what the case is about. Many simply still do not understand the facts.

Our final assessment was that at trial we would probably prevail against the Company. Our prospect to prevail in a trial against specific individuals was considerably less certain.

Evaluation of Negotiations

A major objective of the prosecution was not only to bring an immediate halt to Hutton's money management abuses, but also to make the case a landmark that would establish specific standards of practice for money management. This second objective was linked to our assessment that Hutton's practices, if replicated by financially precarious companies, had tremendous potential for harming banks, particularly the smaller, more vulnerable banks.

At the time we commenced plea negotiations with Hutton, we had assessed our prospects of success in an indictment and trial along the lines discussed above. Essentially, the maximum we could realistically obtain through litigation was the following:

- °Indictment and conviction of the Hutton brokerage subsidiary and possibly its parent, Hutton Group, on approximately 500 mail and wire fraud counts each (the maximum as to which we had venue in the Middle District of Pennsylvania) with a maximum aggregate fine of $1,000,000.
- °No recovery of the costs of investigation, but recovery of some costs of prosecution.
- °Restitution, but possibly limited only to bank victims in the Middle District of Pennsylvania. Restitution would have to await exhaustion of all appeals.
- °Injunctive relief against Hutton for ongoing practices could not be obtained during the pendency of the criminal case because a contemporaneous civil proceeding would have created difficult parallel proceeding problems.
- °Prosecution and conviction of the only individuals against

whom there was sufficient evidence to indict and possible imprisonment. However, because they had not personally profited from the offenses, the likelihood that either would be imprisoned was low, assuming that convictions were obtained.

These objectives could only have been obtained via an extraordinarily lengthy, complex and chancy trial.

The results achievable by plea disposition, on the other hand, were clearly far superior. The issue was simply whether the prosecution of two mid-level individuals, who had not personally gained from the fraud, was of sufficient importance that it warranted accepting the enormous litigation cost and risks that a trial would require rather than the immediate and dramatic benefits provided by the terms of the disposition. Our assessment was that the terms of the plea bargain accomplished such a high percentage of our enforcement goals that it should be accepted.

The Criminal Division policy regarding the prosecution of corporate officials and employees for acts of wrongdoing is that corporations act through individuals and, therefore, individuals must be held accountable for corporate actions. That policy, when placed beside the facts, uncertainties and legal ambiguities of this case, would, if inflexibly applied, have forced us to reject a plea agreement that in many significant ways accomplished more than we could have achieved by a trial. In addition, it would have saddled us with a trial of unprecedented difficulty and high risk. That policy, however, is an important one and is sacrificed only when there is an overriding interest in doing so. The benefits derived from the Hutton plea were so substantial that they clearly warranted an exception to our policy.

The judgment in this case was most heavily influenced by two factors: first, Messrs. Murray, Clark, and Ogren viewed it as absolutely essential to obtain an injunction that barred the full range of Hutton's overdraft practices including the use of the draw down sheet and its multiplier. Hutton had made clear to us its intent to continue its draw down practices involving the use of the multiplier without disclosure to its banks. Hutton further indicated that it was computerizing the process to make it more efficient and uniform throughout the firm's operations. Second, the practices Hutton employed are believed to be wide spread and to cause large interest losses to banks, which posed the threat to inflict huge losses on banks if the overdrawing broker or business failed. Because of Williams, and under the facts of this case, these practices could not be reached by an indictment. However, an injunction, based on the bank fraud statute that overruled Williams, would provide a visible enforcement vehicle.

We ultimately viewed our choice as one between an uncertain prospect of convicting two mid-level individuals who did not gain from the fraud against the certainty of a broad based enforcement stroke that could immediately wipe out cash management abuses throughout the business community.

Conclusion

Based on the foregoing assessment, Messrs. Ogren, Clark and Murray recommended that the plea bargain reflected in Plea Agreement filed with the Court be approved. The key elements of the disposition are:

1. Hutton guilty plea to 2,000 Counts of mail and wire fraud. Fine of $2,000,000 (the legal maximum).
2. Hutton payment of $750,000 in investigative costs (not otherwise recoverable).
3. Hutton make full restitution, plus interest.
4. Hutton take a series of actions to inform and educate its employees in order to prevent a recurrence of abuses.
5. Hutton consent to an injunction that prohibits arbitrary overdrafting, chaining, use of multiplier or

formula, criss-crossing and requires full disclosure of its cash concentration practices to its banks.

The disposition was approved by Assistant Attorney General Trott. Following action by Hutton's Board of Directors, Hutton entered its guilty plea and consent to the injunction before Chief Judge Nealon on May 2, 1985.

Question for Assistant Attorney General Stephen S. Trott:

> It appears that E.F. Hutton had their nationwide cash concentration system in place for several years before any questions were raised about it by federal investigators. How did Hutton's system eventually come to light, and why did investigators not uncover it sooner?

Hutton's basic cash concentration system was in place for more than a decade. While this system was not, as originally designed, a mechanism for the illegal overdrafting of Hutton's depository bank accounts, the system underwent modifications, primarily introduction of the use of a "drawdown sheet," and became a "target balancing" system. For reasons described elsewhere in our testimony, we concluded that for the period charged in the Hutton criminal information, which was prior to the enactment of the new bank fraud statute, 18 U.S.C. §1344, target balancing could not be prosecuted successfully. Other permutations of the Hutton cash concentration system, namely, the "excessive or arbitrary" overdrafts and "chaining" (successive overdrafting of a series of branch depository bank accounts prior to drawing funds into Hutton's primary bank accounts) were, given the misrepresentations made to Hutton's branch banks as to how the depository accounts would be used, criminal acts subject to prosecution under the mail and wire fraud statutes.

I am assuming that your question with respect to how the Hutton system escaped detection by federal investigators relates to the criminal activity, that is, the excessive arbitrary overdrafting and the chaining activity. Federal prosecutors and federal criminal investigators do not have the ability to examine routinely information concerning corporate banking relationships. Other than Hutton itself, only Hutton's banks would have had routine access to the information from which such activity could have been discerned. Assuming Hutton was careful to maintain a zero or positive "ledger" balance at its banks, as opposed to a negative collected balance, routine audits performed by state or federal banking authorities would not have revealed the nature or extent of the illegal activity.

Hutton's scheme was brought to the attention of federal prosecutors only when Mr. Robert Lowe, an auditor for the Genesee Country Bank in Batavia, New York, discovered and reported to his superiors an $8.1 million Hutton debit item which had been presented in connection with a chain operating between several Hutton offices. Discovery of this single item, which exceeded the lending limits of that bank, led directly to the reference of this matter to the United States Attorney's Office in Scranton. Only through the diligence of Albert Murray, the Assistant United States Attorney assigned to the case, and the Postal Inspectors, did the full extent of Hutton's activities come to light. Other banks had, along the way, learned that Hutton was abusing its banking relationships by overdrafting. However, none of these reported Hutton's activities to regulators. Instead, they either monitored Hutton more closely to see that their banks remained in a fully collected position or asked Hutton to take its business elsewhere.

Question For Assistant U.S. Attorney Albert Murray:

> As one of the chief investigators working on this case, what is your judgment as to whether the various financial institutions involved reasonably should have been aware of the abuses and events which were taking place?

The simple answer to your question is "yes." But I would like to elaborate a bit if I may.

E.F. Hutton's nationwide domestic cash concentration system used a network of approximately 400 banks. These ranged from Genesee Country Bank with assets of 78 million dollars to such giants as Chemical Bank, Manufacturers Hanover Trust Co., and Citibank with assets in the tens of billions of dollars. Hutton's cash concentration system used two prime collecting banks, nine regional banks and over three hundred local depositories. Daily, Hutton's banks processed thousands of deposits, representing checks and cash in the hundreds of millions of dollars. Hutton's hundreds of branch office cashiers were in daily communication with their depository banks in order to monitor bank balances. At each bank, tellers or account executives were assigned to handle Hutton's transactions and monitor bank profitability. For reasons outlined below, a large majority, perhaps 95% of these banks, neglected or failed to detect Hutton's abusive management practices. It is my personal opinion that many banking officials intentionally ignored Hutton's conduct in order to maintain an on-going business relationship with the company. Likewise, I believe there is an "unstated partnership agreement" between many banks and the Hutton branches whereby irregularities in banking practices are kept "in house" and are not referred to appropriate local, state or federal regulatory agencies.

Below, I will endeavor to outline generally factors which, singly or in combination, materially affected the Hutton investigation and prosecution:

1. Many mid-size and smaller country banks were unsophisticated in corporate money management techniques such as bifurcated cash concentration systems involving disbursement banks and collecting banks.

2. Major banks, for example, Bank of America, Manufacturers Hanover Trust Company, United States Trust Company, and others, were negligent in monitoring the accounts and did not follow internal bank procedures concerning credit policies, or, alternatively, lacked adequate regulations and controls. Many major, mid-size and smaller banks lacked the computer technology to track floats occurring on an inter or intra day basis. In other words, many banks lacked the ability to analyze their financial risk exposure.

3. Many banks lacked adequate audit capabilities.

4. Many banks failed to conduct monthly account analyses.

5. Many banks failed to devise a system to price float and, therefore, ignored their credit exposure. While Hutton's manipulations took on many different shapes and forms, the banks should have been aware of their financial exposure even if the account was reviewed only annually.

6. Many banks which properly processed checks passed their financial exposure to other institutions which were less sophisticated. Simply put, some major banks may not have cared about or concerned themselves with smaller, less sophisticated banks or other intermediary collecting banks.

7. Many banks should have questioned Hutton as to overall operation of their nationwide cash concentration system, and, specifically, the draw down system in order to determine whether there were consistencies or irregularities as it affected a particular institution.

8. Some banks offset profit in custodial accounts against losses in demand deposit accounts (checking accounts) and, therefore, suffered no loss.

9. Some banks considered the activity to be internal credit decisions and, therefore, charged Hutton net earnings plus a certain percentage override, thereby benefiting from Hutton's scheme.

10. Many of the financial institutions did not believe Hutton's activities were unlawful since the banks, themselves, engaged in float creating techniques designed to benefit the Federal Reserve provisional crediting or other slow clearing intermediary collecting banks.

11. Many banks believed it was impossible to bring a criminal prosecution against Hutton in that Hutton paid or intended to pay all outstanding obligations.

I might add that the above illustrate practical trial problems and substantially contributed to the resolution of the investigation. Moreover, prior to July 1983, I do not believe that the Federal Reserve Board could specifically determine sources of Federal Reserve float and, therefore, it would have been virtually impossible to trace losses to the source of creation. In many instances, Hutton's relationships with the "bank-victim-witnesses" were incestuous because of Hutton's prominence. I personally believe that a more complete Congressional review of bank relationships in the field of cash management would be appropriate.

Department of Justice

TESTIMONY

OF

STEPHEN S. TROTT
ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

PREPARED FOR

THE

SUBCOMMITTEE ON CRIME
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

CONCERNING

CORPORATE CRIME

ON

JUNE 5, 1985

THIS TESTIMONY WAS NOT DELIVERED BECAUSE THE HEARING WAS CANCELLED AT THE CALL OF THE CHAIRMAN.

---- The Office of Public Affairs

I appreciate this opportunity to discuss with you the subject of economic crime enforcement and to give you our perspective on the E.F. Hutton prosecution.

A month ago, in a major speech in Boston, the Attorney General reaffirmed the commitment of the Department of Justice to a vigorous federal white collar crime enforcement program. The Attorney General's statement could not have been more timely. It occurred in the midst of series of landmark events in white collar crime enforcement and at a time when the importance of effective federal white collar crime enforcement is more critical than ever.

I am particularly pleased to have the opportunity to restate for this Subcommittee our commitment to a strong white collar crime enforcement effort.

Our nation faces a white collar crime problem that infects all aspects of our economy and lives. Viewed in terms of dollar impact, the losses caused by white collar offenses are staggering. White collar crimes cost Americans hundreds of billions of dollars every year.

Over $100 million is lost annually through high pressure "boiler room" operations fraudulently selling commodities such as precious metals by telephone. Over one-half billion dollars were lost in the past five years in real estate investment schemes in California alone. Hundreds of millions of dollars have been lost by tens of thousands of investors who have been victimized by fraudulent financial service brokers operating in Florida, California, Utah, Ohio, and New Hampshire. Approximately $80 million was lost in the J. David investment fraud scheme on the West Coast -- a scheme that culminated two months ago in a financier's entry of a plea of guilty. Almost $700 million in losses resulted from a Tennessee bank fraud scheme that concluded with Jake Butcher's plea of guilty several weeks ago. Just this week Butcher received a sentence of 20 years in prison.

White collar crime seriously harms the well-being of our nation. It siphons billions of dollars a year from our economy. It steals the life savings of investors. It adds to the costs of goods and services, and diminishes the revenues otherwise available to the federal and state treasuries. It aggravates the financial burdens of all Americans, who are the indirect victims of fraudulent offenses as well as the direct ones.

The consequences of white collar crime are, however direct and visible. It causes banks to fail. In fact, fraud is a factor in over half of the bank failures in the past five years. White collar crime adds hundreds of millions, if not billions, to the cost of military purchases. It creates defective weapons and military supplies that undermine our ability to defend our nation. It destroys the public's faith in our federal programs such as Medicare and Food Stamps.

Because the economic crime problem is so widespread and the cases themselves so complex and resource intensive, it is vitally important that the federal enforcement effort not be encumbered by antiquated laws, limited techniques, or wasted efforts. The white collar crime provisions of the Comprehensive Crime Control Act enacted by Congress in 1984 were particularly welcomed. That Act toughened the penalties for Title 31 currency act violations. It enacted a broad bank fraud statute. It created an injunctive remedy to respond to the problem of ongoing criminal conduct. The fine provisions of the Fine Enforcement Act of 1984 will substantially increase the cost of committing crime for the white collar criminal. Maximum fines per violation are now $250,000 for individuals and $500,000 for corporations. Using these weapons we can seek to strip the white collar criminals -- both individuals and corporations -- of every last penny of their ill-gotten gains. Considerable progress has been made. But further progress is needed. In the near future we will submit to the Congress a comprehensive legislative package that will improve our ability to respond to defense procurement frauds. In addition, we will propose legislation that will enhance our ability to prosecute professional money launderers and will further enhance our ability to handle bank fraud prosecutions. We hope you will join us and vigorously support these legislative initiatives.

The key to any federal white collar crime enforcement effort is to use our resources as efficiently and effectively as possible. That requires selecting our priorities with care, developing close cooperation among all elements of law enforcement, crafting creative strategies and carefully utilizing our resources in the most effective manner.

In 1983, Attorney General Smith created the Economic Crime Council to serve as an advisory body on white collar crime enforcement policy within the Department of Justice. The Council is chaired by the Deputy Attorney General. Its membership includes 21 United States Attorneys and officials of the Criminal Division and the FBI, and, beginning this year, the Antitrust, Civil and Tax divisions of Department of Justice. One of the Council's principal roles has been to aid in developing white collar crime priorities. The Council, working in conjunction with the Criminal Division, has defined our law enforcement priorities sharply and clearly. We are concerned about areas that affect our national defense, our banking system, the taxpayer and the investment public. The six principal priority areas are defense procurement frauds, frauds against banks and savings and loans, investment "boiler room" frauds, money laundering, various types of securities frauds, and health care frauds. We must strike decisively and effectively against such economic crimes because they corrupt the economic integrity of our society and its institutions.

One priority area of prosecution -- bank fraud -- is of particular relevance to today's hearings. Fraud against banks is a major concern of the Department of Justice for one simple reason. Over one half of the bank failures in the United States in the last five years were either caused by or related to criminal conduct. That fact is deeply disturbing. The nation's economic health turns on stability in its banking institutions. With this objective in mind, former Attorney General Smith and the heads of the bank regulatory agencies created a task force last December to revise the referral mechanism that brings bank fraud cases into the criminal justice system and to develop improved methods for handling major bank fraud cases. The result of that effort, announced by Attorney General Meese two months ago, is an interagency agreement which has already improved our handling of significant bank fraud cases. One specific objective of the task force -- and one relevant to these hearings -- was to improve the enforcement mechanism so that action could be taken to prevent banks from failing.

Before turning to the specific facts of the Hutton case, I want to address briefly two other points.

We believe there are a number of ingredients to a successful criminal enforcement effort. Certainly the dominant one is the prosecution, conviction and imprisonment of all individuals who perpetrate crime. But that traditional solution, in many instances, does not go far enough. It does not take into account the need to prevent crimes before they occur, or to bring cases which by their scope, and the swiftness by which they become final, provide clear, dramatic warning that specific conduct will be prosecuted. It also ignores the need, in the very special setting of offenses committed to benefit corporations, to impose direct and substantial sanctions upon the corporation, in addition to those imposed on the individuals, and to force the corporation to adopt internal control mechanisms that will prevent future criminal conduct and substantially alter the ways in which the corporation conducts its affairs.

Our white collar crime enforcement program is a varied and successful one. Statistics tell us we are prosecuting more economic crime now than ever. White collar crime prosecutions have risen as a percentage of total federal prosecutions from 8% to 1970, to 20% in 1980 and to 24% in 1983 and 1984. Numbers, however, do not begin to tell the full story. Certainly the cases are more significant than ever. Within just the last 70 days our national effort includes these remarkable events:

o General Electric Company was indicted and convicted in Philadelphia charges of defrauding the Defense Department and was simultaneously suspended from doing business with the United States Government. Two individual employees of General Electric were also indicted for perjury and obstruction of justice with respect to the grand jury investigation in the case.

- o Jake Butcher entered guilty pleas to several indictments and has been sentenced to 20 years in prison for looting a series of banks in Tennessee and Kentucky. Two of his accomplices have also been convicted and await sentencing.
- o Paul Thayer, former Deputy Secretary of Defense, and Dallas stockbroker Billy Bob Harris were sentenced in Washington, D.C. to four years in prison for obstruction of justice in connection with their roles in a million dollar insider stock trading scheme.
- o a 35-year prison term was imposed on Fred Soudan in Houston, Texas, for his role in master minding the largest maritime fraud in history -- the infamous sinking of the super tanker "Salem" off the west coast of Africa.
- o the Attorney General announced a comprehensive overhaul of and improvements in the mechanism for referring bank fraud cases for criminal prosecution.
- o six defendants were convicted in Texas of Foreign Corrupt Practices Act violations in the $10 million Pemex/Crawford foreign bribery scheme and are awaiting sentencing.
- o the conviction of J. David Dominelli in San Diego on mail fraud charges in connection with the J. David Company an investment scheme that defrauded 1,500 people out of $200 million.

- conviction of the LeBlanc brothers in Detroit for an investment scheme in which 800 investors lost $10.5 million.
- Indictment in Florida of convicted con-man and boiler-room operator Jack Rose in a scheme that bilked 1,200 investors out of $12 million in a precious metals scam.
- Conviction of E.F. Hutton and Company, Inc. of 2,000 counts of mail and wire fraud in a nationwide check-kiting scheme and unprecedented civil injunctive relief.

I seriously doubt whether there was ever a collection of more significant white collar crime cases resolved in such a short period of time. And I can promise you more are to come in the months ahead, most in our national priority areas.

We are proud of this record and, with respect to the subject matter of today's hearing, we are proud of the results achieved in E.F. Hutton prosecution. By any standard, the Hutton case is a landmark and its law enforcement accomplishments are noteworthy.

The facts of the Hutton case are enormously complex as you will learn in our detailed briefing. Most public comment on the results in the case has been based both on a serious misunderstanding of the unusual factual and legal setting of the case and a failure to appreciate the litigation risks faced in the prosecution. We have heard no criticism from regulators, bankers, lawyers and responsible corporate managers who have taken the time to study what was done in the Hutton case. The message of the Hutton case has been read loud and clear by those immediately affected by it. To aid your understanding, I am appending to this statement a summary of the Hutton case, which includes a description of its legal setting, the litigation risks we confronted and the relief we obtained.

The Hutton prosecution is without precedent in the federal system. Some of the practices embraced by our enforcement action were probably legal until enactment of the bank fraud statute last October. Nevertheless, they constituted serious abuses that threatened to inflict significant losses on banks. The perpetrators did not believe they were committing a crime, although in fact their acts now are clearly illegal and many of them were at the time. The investigation covered 3 years and ultimately involved the analysis of 7,000,000 million documents. On top of these difficulties, we recognized that many of Hutton's most serious cash management abuses could not be reached by a conventional criminal prosecution.

Our prosecutors had to choose. The first option: a conventional prosecution of Hutton and two mid level individuals, would have been costly, inefficient, had a questionable prospect of success and could not reach the most widespread abuses of Hutton and the rest of the money management community. The second option: a comprehensive settlement that we judged would address most directly the serious problem of widespread money management abuses.

For what amounted to deceiving banks into giving it interest-free unsecured short-term loans, Hutton was required to plead guilty -- not nolo contendre but guilty -- to an unprecedented 2,000 felony counts of intentional mail and wire fraud. It was fined $2,000,000, the maximum the law allows for this unparalleled number of counts, and a sum which makes it the steepest fine in the history of our white collar enforcement effort. Hutton was also required to pay the Government $750,000 to cover the costs of the investigation. Those costs are ordinarily not recoverable, even with a jury verdict of guilty. Additionally, the new injunctive provision of 18 U.S.C. §1345 was used for the first time since its enactment by Congress in October 1984 to enjoin all of Hutton's cash management abuses, not just those precisely identified in the criminal information, many of which were not criminal prior to enactment of the Comprehensive Crime Contract Act.

The Department of Justice also required that Hutton immediately make full and complete restitution, with interest, to each and every one of the bank victims without regard to the federal district in which they reside. Rarely is there a criminal fraud case where this much immediate benefit flows to victims. Usually victims interests are handled as an afterthought. It is incorrect to assume or infer that restitution is limited to the $8,000,000 Hutton has reserved for this purpose. Hutton is obligated to pay back the total amount obtained fraudulently, plus interest, whatever that may be. In sum, this is the most comprehensive program of restitution ever developed in a federal criminal case.

As I noted before, one of the important priorities of the Department of Justice is the protection of the banking industry itself from fraudulent schemes. Predatory money-management practices and cash concentration systems have become, in the hands of a few, a science that can threaten our banking institutions. Professionals working in that specialty have associations which sponsor conferences, exchange information, and publish articles. Their sophisticated activities and techniques have a definite impact on our nation's banks and financial institutions of which few people are aware. The Federal Reserve has been highly critical of "float creating" and "float-playing games," of which Hutton's was an extreme example, and we are in agreement with that concern. Hutton's practices had tremendous potential for harming banks, particularly the smaller, more vulnerable ones. The injunction covers conduct that we were unable to include in our criminal charging document and thus we achieved important multiple objectives in a single decisive stroke. This conviction and injunction sent a clear message to professional money managers around the country. There should be no doubt that these kinds of abuses are criminal and will be prosecuted.

The public must have faith in the stability of our financial institutions, and they must have it today, not tomorrow. Naming numerous small banks victimized by Hutton in an unresolved indictment and alleging widespread fraud and losses had the capacity to undercut public confidence in those banks. If that route had been chosen and runs on deposits had developed, the situation would have been highly undesirable. One only has to look to the recent problems in Ohio and Maryland to see how fragile public confidence can be when it appears to depositors that the financial institution to whom their money has been entrusted is on shaky ground. The plea of guilty, the injunction plus complete restitution without a risky, costly, and lengthy trial achieved our objectives, now, not two or three years from now. The word is out. The cloud is gone. The matter has been favorably resolved without the uncertainties and vagaries of the protracted trial we estimate would have involved some 300 witnesses and several hundred thousand documents.

Several aspects of the case deserve mention. As we have described more fully in the case summary submitted with this testimony, check kiting became difficult to prosecute as a result of the Supreme Court's decision in United States v. Williams, 458 U.S. 279 (1982). The theory prosecutors traditionally employed was that an overdraft check constituted an "overvalued security" or a "false statement" to the bank which honored it. The Supreme Court rejecting that theory held that a check made no representation as to the state of the bank account on which it was drawn, and, moreover, was not an overvalued security.

As you know, we recommended remedial legislation to the Congress to cure this problem and that provision, 18 U.S.C. §1344, was adopted as part of the Comprehensive Crime Control Act of 1984.

Before passage of §1344, the principal alternative to §1014 as a check kite prosecutive vehicle was mail or wire fraud in the limited cases where those statutes applied. In the Third Circuit, however, Williams took its toll on the "mail fraud/wire fraud" approach to prosecuting check kites. In United States v. Frankel, 721 F.2d 917 (3rd Cir. 1983), the Court relied on Williams to conclude that a check kite could not be charged under the "false pretenses, representations and promises" clause of 18 U.S.C. §1341 because a check was not a representation. Frankel left open the possibility of a prosecution under the "scheme to defraud" clause, but failed to explain how that could be done.

The net effect of the Williams and Frankel decisions was to circumscribe our ability to prosecute check kites. Finding a theory that would not lead to a dismissal under either Williams or Frankel was not simple. The theory we adopted, and which is reflected in the Hutton criminal charges, focused on a misrepresentation of Hutton's relationship with its banks: Hutton held itself out as creating depository accounts to handle only customer money where in fact the accounts were used to process huge overdraft checks. This is a rather unconventional and untested prosecutive approach to check kiting and turned completely on our ability to establish persuasively that the depository accounts were intended for a highly specific limited use. Obviously, this creative circumvention of Williams and Frankel would have been tested vigorously pre-trial and post-conviction.

The second legal defense we expected was a claim of good faith. Hutton alleged it was guilty merely of aggressive money management. In fact, Hutton insisted that they had done nothing wrong and had only attempted to "recapture float" that did not belong to the banks. Hutton insisted that its practices were no different than those of other companies.

The third possible legal attack on our case, available to the individuals who might have been charged, was the simple claim that each was acting pursuant to corporate policy and, because Hutton had the means to pay the banks, the requisite mens rea or intent to defraud was absent.

As to the individuals primarily responsible in a criminal sense for this activity, there were essentially two key people. Beyond that they cannot be identified -- nor can the evidence against them be detailed or characterized -- because of Rule 6(e) of the Federal Rules of Criminal Procedure that requires continuing secrecy with respect to matters occurring before a grand jury. However, neither individual was a high-level executive of the company.

In assessing the manner in which this case ought to be handled, our prosecutors started from the proposition that individuals ought to be held personally responsible for their criminal misconduct. This is our normal policy from which we deviate only when faced with a compelling reason to make an exception. Pursuing at trial the known individual authors of these abuses would have had some merit, but not at the expense of foregoing the opportunity to dictate the key terms of, and seize without delay, this extraordinary settlement. To prosecute the individuals would have required us to drop the settlement in favor of a protracted court fight that would have taken years to complete. That was the choice. Our career prosecutors opted for the numerous overwhelming benefits of the immediate solution, and we find their judgment to be absolutely sound and above approach. The benefits derived from the Hutton plea were so substantial that they clearly warranted an exception to our policy of affixing personal responsibility for wrongdoing.

Summary of the E.F. Hutton & Company Inc. Investigation and Prosecution

In December 1981, a check kite being operated by a number of E.F. Hutton & Company Inc. ("Hutton") branches collapsed when an $8,100,000 check was bounced by the Genessee Country Bank of Batavia, New York. This event triggered a joint inquiry by the New York State Banking Commission and the Federal Reserve Bank of New York. Ultimately an FDIC examiner learned of the incident and, because the kite involved checks drawn on the United Penn Bank in Wilkes-Barre, Pennsylvania, the examiner referred the matter in March 1982 to the United States Postal Inspection Service in Scranton, Pennsylvania, and to the United States Attorney in Scranton. Assistant United States Attorney Albert R. Murray, Jr. of the Middle District of Pennsylvania was assigned to the case.

After reviewing the allegations and events surrounding the Genessee/United Penn kite, Assistant United States Attorney Murray opened a grand jury investigation. [1/]

Staffing and Scope of the Investigation

The investigation commenced in April 1982 and continued until May 1985. Assistant United States Attorney Murray believed it possible that the Genessee kite was evidence of more wide spread abuses by Hutton. The investigation was structured to test that theory. The investigation was staffed by Assistant United States Attorney Murray and a Postal Inspection team headed by Postal Inspector John Holland of the Harrisburg office. Assistant United States Murray, who had previously been in private practice, became an Assistant United States Attorney in January 1980. Mr. Holland has been a postal inspector for 14 years. Peter B. Clark, an experienced Criminal Division Fraud Section attorney, previously in private practice and a Special Counsel in the Enforcement Division of the Securities and Exchange Commission, joined the prosecutive team in August 1984.

[1/] During the grand jury investigation the Supreme Court decided *United States* v. *Williams*, 458 U.S. 279 (1982) which drastically curtailed federal prosecutions of check kiting. See discussion *infra* under "Legal Theory and Problems."

The site of the investigation, for logistical and tactical reasons, was Harrisburg, Pennsylvania. One key reason was to limit the possibility of publicity. The grand juries that investigated the Hutton matter were located in Harrisburg.

During the investigation numerous witnesses testified before the grand jury, many on more than one occasion. Many witnesses insisted upon use immunity protection, which was supplied in the form of a letter in lieu of statutory §6001 immunity. In each instance, proffers were received in advance of the immunity grant. No immunized witness was a target of the grand jury investigation.

Except for those who invoked the Fifth Amendment and refused to testify, all relevant Hutton headquarters personnel were interviewed.

John S.R. Shad, Securities and Exchange Commission Chairman, was, until 1980, vice-chairman of the board of Hutton. There was no evidence nor any allegation that Mr. Shad had participated in the check scheme or indeed knew about it. Mr. Shad was interviewed and we concluded that he had no connection with the scheme.

Over 300 subpoenas were issued during the investigation. The number of documents obtained by subpoena was approximately 7,000,000. One of the principal initial tasks was to organize the subpoenaed documents pursuant to a system that permitted orderly retrieval. The documents were physically maintained at the main postal facility in Harrisburg. Because their volume exceeded available space in the Postal Inspection Service offices, the records were maintained in a large, specially constructed, locked area of the post office basement.

A major task of the investigation was to acquire a working knowledge of Hutton's cash concentration system and the Federal Reserve and bank check collection systems. A substantial portion of the investigative effort during the first 18 months was devoted to accomplishing these objectives.

A further point should be noted. The original investigative focus was Hutton's activity within the Middle District of

Pennsylvania. Until 1984, the investigation did not focus on practices and specific abuses that occurred nationally. The narrow geographic focus of the first half of the investigation was dictated by the original allegations and the venue limitations of federal criminal jurisdiction.

Once it became clear that Hutton's activities were not mere isolated episodes but appeared to reflect a widespread corporate practice, Assistant United States Attorney Murray's objective was to place responsibility for this practice at the highest possible level within Hutton. As a general rule, this strategy led to the pattern of interviewing branch personnel (most of whom sought and obtained immunity), and subsequently certain regional personnel, in an effort to build a case against the members of management responsible for devising and implementing Hutton cash concentration policies. In that regard, it is important to note that vast majority of those who sought and received "immunity" were not criminally culpable in the scheme. Informal immunity is often sought by attorneys representing non-culpable persons in an investigation.

What Hutton Did

In the late 1970's, Hutton had in place a cash concentration or "draw down" system by which the funds collected from its customers at over 400 branch offices throughout the country were moved to bank accounts in New York and Los Angeles, where the funds were available for Hutton's business uses. These customer funds, which amounted to between $200 and $400 million each business day, were first deposited in local bank accounts maintained by each Hutton branch. Hutton advised its branch depository banks were advised by Hutton that these accounts would be used to deposit funds received from the firm's local customers and to transfer these funds to Hutton's regional and prime concentration bank accounts. The local depository banks granted Hutton "next-day" availability on these deposits, that is, on the business day following the deposit of local customers' checks, Hutton would be permitted to withdraw funds in the amount of the deposited items. The branch depository banks believed Hutton would be depositing checks Hutton had received from local Hutton customers, and that the banks would be collecting them on the following business day. Therefore, the banks assumed they would be in a collected position by the time Hutton withdrew the funds.

While Hutton could have transferred its collected or available funds from its hundreds of branch depository accounts to its prime concentration accounts by bank wire transfers, this procedure would have required over 150,000 wire transfers each year at an estimated cost in excess of $1 million. Instead, Hutton "drew down" its branch depository accounts by means of a system which, each business day, required (1) Hutton branch office personnel to determine the collected balance in each branch depository account and telephone that information to the branch's regional office; (2) Hutton regional office personnel to draw checks manually on each branch depository account in their region, deposit the checks in a regional depository account and telephone that information to the firm's cash desk in New York City; and (3) Hutton main office personnel to draw checks on each regional depository account or otherwise direct the transfer of funds from the regional depository accounts to the firm's prime concentration accounts in New York City or Los Angeles. This system, so long as only collected funds were drawn down, was legal.

Hutton's illegal conduct was a series of variations on its established "draw down" system. Hutton modified the legal draw down procedure to withdraw funds from its branch depository accounts in arbitrary amounts well in excess of either customer receipts or the collected balances in those accounts. To do this, Hutton had to "cover" or otherwise conceal the overdrafts it created by depositing into those accounts checks drawn upon other Hutton accounts. These overdrafts, in turn, were hidden from the depository banks by covering checks drafted by Hutton branch personnel and deposited into bank accounts. These checks, available in each Hutton branch office, were drawn upon "zero balance" accounts at one of two New York City banks. By agreement with these banks, Hutton was required to keep no minimum balance but rather was permitted to wire transfer into the accounts, on a daily basis, sufficient funds to cover all checks presented for collection that day.

Furthermore, the covering "zero balance" checks, unlike the local Hutton customer checks which would be collected within one day, took a minimum of two days to clear. Nevertheless, branch depository banks, not realizing that these were not deposits of local customer funds, permitted Hutton to have "next-day" availability on these items as well. Hutton thus exploited the customary bank practice of examining only the ledger balance to determine whether an overdraft exists in an account. As Hutton's branch office personnel were continually depositing Hutton's own checks into the depository accounts, these deposits appeared on the bank's ledgers to balance Hutton's withdrawals. In actuality, because of the minimum one extra day in the collection of a Hutton "zero balance" check, the account was overdrafted for an equivalent period.

Overdrafting was accomplished in a variety of ways, the most blatant being the simple addition of a "zero" to the branch depository transfer check. In this manner, a $100,000 deposit of customers' funds would be arbitrarily increased to $1 million as it was drawn down and a Hutton "zero balance" check in the amount of $900,000 would be deposited in the account to cover the overdraft.

Two specific instances of arbitrary overdrafting, drawn from the Rule 11 proceeding, show dramatically the essence and scope of the Hutton scheme. On November 2, 1981, the Hutton branch office in Williamsport, Pennsylvania deposited $92,475.12 in customer funds in its account at the Northern Central Bank in Williamsport. That day, the amount drawn down from the account into the firm's prime concentration account was $925,000. The difference, $832,524.88, was made up by a check drawn in that amount by Hutton's Williamsport branch office on the firm's zero balance account at Chemical Bank in New York City. This pattern was repeated at the Northern Central Bank throughout November 1981.

On the same day, November 2, 1981, the Hutton branch office in Alexandria, Virginia received customer funds in the amount of $70,629.46 which it deposited in its account at United Virginia Bank. The amount drawn down from the account that day was $9,953,400. The overdraft was covered with a zero balance account check. Between January and December 1981, the Hutton branch in Alexandria received a total of $33,537,397.20 in customer funds and withdrew from its depository account at United Virginia Bank some $640,796,712.08, well over one-half billion dollars in overdrafts. The average daily overdraft at this bank was approximately $9,000,000 in November 1981.

A complimentary, and more pernicious, scheme was the practice of "chaining" whereby Hutton caused funds to be transferred between various branch and regional depository bank accounts prior to deposit in a prime depository account for the purpose of providing additional points for the arbitrary increase of withdrawals and to increase the opportunity for and likelihood of delays in the clearing times of the covering "zero balance" checks.

In the course of the investigation, approximately fifty such "chains" were uncovered which operated in all parts of the country during 1981 and part of 1982. The practices of "chaining" and arbitrary overdrafting occurred principally in 1981. Within several months of the collapse of the Genessee/United Penn kite, those activities were halted.

By overdrafting as much as $250 million per day from its depository accounts, and perpetuating its overdrafts on successive days, Hutton both avoided the necessity to borrow extensive amounts of working capital and earned interest income on surplus funds.

Under one part of the plea agreement, Hutton was enjoined in the §1345 civil injunctive proceeding from engaging in two additional practices not charged in the criminal information.

The first was the use of a "draw down sheet" or formula by which Hutton sought to overdraft its depository bank accounts in an amount which it claimed compensated the firm for the weekend and holiday periods during which funds were unavailable to Hutton. The essence of the draw down sheets was a "multiplier" which increased the amount withdrawn on certain days by a factor of two, three or four.

Hutton's objective in using the draw down sheet and its multiplier was to achieve a "target" or average balance of zero in each of its branch depository bank accounts. To the extent that banks held Hutton funds on weekends or holidays, Hutton recaptured use of that money by precisely calculated overdrafts. While this conduct was not as egregious as the massive, arbitrary overdrafting exemplified by the Williamsport and Alexandria cases, the activity was far more pervasive. Unfortunately, from a criminal prosecutive standpoint, the target balancing technique may be relatively common and was certainly one not considered illegal by Hutton's employees. Without the §1345 civil injunction, the target balance activity would have continued at Hutton.

Another practice was the daily "criss-cross" of checks between two Hutton bank accounts for the purpose of inducing these banks to certify a daily opening balance in each account. Both banks were thereby induced to certify that Hutton had opening balances aggregating substantial sums when the actual aggregate balance was almost zero.

All of these activities--both the practices charged in the information and the activities prohibited in the final judgment of permanent injunction in the civil proceeding--were designed, instituted and promoted by Hutton's money management personnel. The investigation did not develop sufficient evidence to merit the prosecution of any individuals superior to these persons in the Hutton organization.

There are two primary reasons why the money management personnel, rather than senior management, were responsible for these abuses. First, the operations of a brokerage firm such as

Hutton are organized into two functional areas: the "front office," which performs all the sales related activities and the "back office," which handles the paperwork generated by the front office and all of the other day-to-day operations of the firm. The registered representatives are the best compensated and are rewarded by promotion to management positions. The back office personnel, who perform the mundane, albeit, in some cases, extremely responsible, tasks are not well compensated and have virtually no opportunity to advance into the senior management levels of a brokerage firm. Senior managers, selected without exception from the ranks of the front office, have neither the experience nor inclination to become involved with back office management. Second, unlike some other major brokerage firms, Hutton's regional and branch operations were effectively "decentralized." Indeed, the regional and branch managers were encouraged to be independent; Hutton closely monitored profit and loss figures for each branch.

It was in this context that Hutton's money managers operated. It was clear from the investigation that they lacked the authority to impose uniform money management procedures throughout the Hutton branch office organization. Although various "draw down" sheets were devised and tinkered with and small meetings and seminars held at irregular intervals to encourage their use, not all branch offices followed the money management office's suggestions. One major reason was that the formula computations required to complete the draw down sheet were complicated and not every branch manager or cashier could do them. Few of the branch cashiers grasped the illegal nature of the activity which the sheets fostered. Furthermore, the evidentiary link between Hutton's money management office and the type of activity found at the Williamsport or Alexandria branch offices was tenuous. Hutton's policy of considering each branch office as an independent profit center led, inexorably, to a sharing with the branch offices of a portion of the interest income being generated by the money management techniques. Some branch office managers, whose compensation was, in part, based upon their office's profitability, were undoubtedly tempted by the opportunities for indirect personal benefit provided by the ability to engage in overdrafting of branch depository accounts. Branch office personnel, however, did not create the scheme and, except for a few instances, did not comprehend its illegality.

Legal Theory and Problems

Check kiting became extremely difficult to prosecute under federal law as a result of the Supreme Court's decision in United States v. Williams, 458 U.S. 279 (1982). The typical check kite case had been prosecuted in the federal system as a violation of 18 U.S.C. §1014. The relevant language is:

> "Whoever knowingly makes any false statement or report, or willfully overvalues any land, property or security, . . . for the purpose of influencing in any way the action of . . . any bank the deposits of which are insured by the Federal deposit Insurance Corporation . . . upon any application, advance, discount, purchase, purchase agreement, repurchase agreement, commitment, or loan, or any change or extension of any of the same, by renewal, deferment of action or otherwise, or the acceptance, release, or substitution or security therefor, shall be fined not more than $5,000 or imprisoned not more than two years, or both."

The theory employed by federal prosecutors was that a kited check was an "overvalued security" or a "false statement." The Supreme Court held, however, that a check does not "make any representations as to the state of petitioner's bank balance," 458 U.S. at 285, nor is it an overvalued security."

The consequence of Williams was to limit drastically federal law enforcement's ability to prosecute check kites. In March 1983, the Department of Justice recommended remedial legislation in the form of a comprehensive bank fraud statute. A year and one half later that statute was adopted as part of the Comprehensive Crime Control Act of 1984 and is codified at 18 U.S.C. §1344. The legislative history makes it clear that §1344 reverses Williams.

Before passage of §1344, the principal alternative to §1014 as a check kite prosecutive vehicle was mail or wire fraud in the limited cases where those statutes applied. In the Third Circuit, however, Williams, took its toll on the "mail fraud/wire fraud" approach to the prosecuting check kites. In United States v. Frankel, 721 F.2d 917 (3rd Cir. 1983) the Court relied on Williams to conclude that a check kite could not be charged under the "false pretenses, representations and promises" clause of 18 U.S.C. §1341 because a check was not a representation. Frankel left open the possibility of a prosecution under the "scheme to defraud" clause, but failed to explain how that could be done. 2/

The net effect of the Williams and Frankel decisions was to eliminate almost completely our ability to prosecute check kites in the Third Circuit. Finding a theory that would not lead to a dismissal under either Williams or Frankel was not simple. The theory that was adopted focused on Hutton misrepresenting its relationship to the banks: Hutton held itself out as creating depository accounts to handle only customer money where in fact the accounts were used to process huge overdraft checks. This is a rather unconventional prosecutive approach to check kiting and turned completely on our ability to establish persuasively that the depository accounts were intended for a highly specific limited use. Obviously, this creative circumvention of Williams and Frankel would have been tested vigorously by a motion to dismiss.

The second legal defense we expected to face was a claim of good faith. Hutton asserted that it had done nothing wrong and was guilty merely of aggressive money management. Hutton also alleged it had merely attempted to "recapture float" that did not belong to the banks. Hutton insisted that its practices were no different than those of other companies.

2/ The possibility of ITSP (18 U.S.C. §2314) remained, but only as an illusion since that statute requires proof of a fraud. The Williams and Frankel problems led again to the issue of how to define the fraud without relying on the overdraft check as a misrepresentation.

The third legal attack on our case, available to the individuals who might have been charged, was the simple claim that each was acting pursuant to corporate policy and because Hutton had the means to pay the banks, the requisite mens rea was absent. It is clear that each of the few employees that might have been prosecuted firmly believed his conduct was legal.

The final legal defense was essentially the caveat emptor view that since the banks in fact could observe the transactions, they acquiesced in them.

Process of Evaluation

The Criminal Division was first apprised of the Hutton investigation on March 5, 1984. In April 1984, Fraud Section Chief Robert W. Ogren met in Harrisburg, Pennsylvania with Assistant United States Attorney Murray, Inspector Holland and a number of postal inspectors. The purpose of the meeting was to explore possible theories of prosecution, assess the progress of the investigation, and assess whether staffing of the investigation was adequate.

By mid-summer, it was clear that an additional prosecutor was needed to co-counsel the case, to share the work load with Assistant United States Attorney Murray, to complete the grand jury investigation and to assist in sharpening the focus of the remainder of the investigation. Peter B. Clark of the Fraud Section of the Criminal Division was selected.

Assistant United States Attorney Murray had begun working on a draft indictment in the summer of 1984. The timetable to which the prosecutive team sought to adhere contemplated returning of an indictment in November 1984, shortly before the grand jury's term expired. Thereafter, the grand jury's term was extended for six months to May 1985 to finish the investigation and to permit thorough review of the evidence and theory of prosecution.

Simultaneously with our efforts to complete the investigation late in 1984, the various defense counsel representing Hutton and several targeted individuals sought to make presentations to United States Attorney David Dart Queen in

Scranton, Pennsylvania and to the Criminal Division. Mr. Ogren responded to all requests from counsel to meet with Department officials by requiring counsel to present their positions in the first instance to the United States Attorney in Scranton. Several meetings were held in Scranton at which the prospective defendants' positions were set forth. These meetings were held in October and early November.

Counsel for Hutton then requested the opportunity to make written presentations to the Criminal Division and to make an oral presentation to Assistant Attorney General Stephen S. Trott. We agreed to review Hutton's written position and prescribed a timetable for written submissions. The written submissions, which were voluminous, were reviewed in detail. We subsequently agreed to meet with counsel and the oral presentation was scheduled and held on January 7, 1985. [3]

In mid-January 1985, in Harrisburg, Fraud Section Chief Ogren reviewed the evidence against Hutton with Messrs. Murray, Clark and Holland. [4] The purpose of this review was to provide a recommendation to Assistant Attorney General Trott for or against indictment of Hutton. This review led to the conclusion that criminal charges for mail and wire fraud could be brought against Hutton if the theory of prosecution was narrowly focused on the grossly excessive overdrafts and the phenomena of overdraft "chains." It was also clear that the evidence might support charging some individuals but review of that issue was temporarily deferred. Meanwhile, Mr. Ogren requested Messrs. Murray and Clark and the Postal team to develop evidence of additional chains as a priority matter. Fraud Section Chief

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[3] Attending were Trott, Deputy Assistant Attorney General Victoria Toensing, Ogren, Clark, Murray, Holland and Supervising Postal Inspector Thomas Dagley, plus counsel for Hutton.

[4] In January 1985, United States Attorney Queen resigned his office and the Fraud Section of the Criminal Division, which had been assisting in the investigation, assumed direct supervision of the matter.

Ogren reported his conclusions and recommendations to Mr. Trott, who in turn asked Mr. Ogren to advise Hutton's counsel that he had made a decision to proceed to indict. Mr. Ogren advised Hutton's counsel of Mr. Trott's decision.

Two weeks later, in Harrisburg, Messrs. Ogren, Murray, Clark and Holland conducted an intensive review of the evidence against target individuals. The preliminary assessment was that we had sufficient evidence to proceed against two Hutton employees. The tentative conclusion was also reached that additional evidence would be required before any other individuals could be added to the list of probable defendants. Counsel for the employees were advised of our decision and in turn they sought to make presentations on their clients' behalf. Meetings with these counsel took place in February 1985. [5]

Assessment of Risks of Trial

A major component of the judgmental equation was the risk faced in litigating the criminal case with two or more individuals joined as defendants.

An indictment would have resembled the information, but would have been limited to counts involving jurisdictional uses only in the Middle District of Pennsylvania. The focus of an indicted case would have been on two types of check abuses: the arbitrary overdrafts exemplified by the Williamsport and Alexandria situations and branch-to-branch chains exemplified by the Genessee/United Penn kite. In order to demonstrate the breadth and significance of the scheme we expected to prove six or more arbitrary overdraft situations and at least twenty chains.

The scope and complexity a potential trial was unprecedented. Of the 7,000,000 documents subpoenaed by the grand jury, our estimate is that several hundred thousand would have been needed at trial. The number of authenticating witnesses alone would have exceeded 200.

5/ Attending for the government were Messrs. Ogren, Clark, Murray and Holland.

Several hundred descriptive charts would have been required. Approximately 20 charts were prepared for use in the Rule 11 proceeding simply to explain the theory of the government's case to Chief Judge Nealon.

In addition to hundreds of authenticating witnesses, we would have presented over one hundred fact witnesses and a number of experts.

Pretrial discovery in this case would have taken months.

Although the case management problems of the prosecution were enormous, and the expense of the litigation would have been considerable, other factors were of greater importance.

Put bluntly, this case was not a sure winner against individuals. The probable legal defenses mentioned above were not weak. In addition, there were a number of serious practical problems. The most significant:

- The prospective individual defendants did not gain personally from their offenses. This defense has historically been an effective one with juries. Our most recent example is the acquittal on May 10, 1985, of George McLean, a former International Harvester employee, in the Pemex FCPA prosecution.
- The banks in many instances should have uncovered the fraud. It could appear they had turned their heads to avoid discovering it (in which case it would have been argued that it was not a fraud).
- We recognized that two attitude factors might contribute to jury nullification: one might best be described as a "to hell with the banks" attitude; the second, the "there but for the grace of God go I" attitude reflecting the reality that, at one time or another, most jurors have overdrawn their accounts. These two attitudes, coupled with a defendant's demonstrable ability to pay, have historically made check kite and bad check cases extremely difficult to prosecute successfully.
- Severance problems. In all likelihood, one individual

defendant would have been entitled to a severance. Thus the case would have been tried twice.

- Confusion. Although, we believe the clarification of the theory of prosecution and limitation of the proof to arbitrary overdrafts and chains was constructive, the government's evidence was complex and difficult to understand. It is noteworthy that after several weeks of our providing detailed briefings and answering questions for Congress and the Press, only a handful of the reporters and political figures who have written or commented on the case appear to have any idea what the case is about. Many simply still do not understand the facts.

Our final assessment was that at trial we would probably prevail against the Company. Our prospect to prevail in a trial against specific individuals was considerably less certain.

Evaluation of Negotiations

A major objective of the prosecution was not only to bring an immediate halt to Hutton's money management abuses, but also to make the case a landmark that would establish specific standards of practice for money management. This second objective was linked to our assessment that Hutton's practices, if replicated by financially precarious companies, had tremendous potential for harming banks, particularly the smaller, more vulnerable banks.

At the time we commenced plea negotiations with Hutton, we had assessed our prospects of success in an indictment and trial along the lines discussed above. Essentially, the maximum we could realistically obtain through litigation was the following:

- Indictment and conviction of the Hutton brokerage subsidiary and possibly its parent, Hutton Group, on approximately 500 mail and wire fraud counts each (the maximum as to which we had venue in the Middle District of Pennsylvania) with a maximum aggregate fine of

$1,000,000.

- No recovery of the costs of investigation, but recovery of some costs of prosecution.
- Restitution, but possibly limited only to bank victims in the Middle District of Pennsylvania. Restitution would have to await exhaustion of all appeals.
- Injunctive relief against Hutton for ongoing practices could not be obtained during the pendency of the criminal case because a contemporaneous civil proceeding would have created difficult parallel proceeding problems.
- Prosecution and conviction of the only individuals against whom there was sufficient evidence to indict and possible imprisonment. However, because they had not personally profited from the offenses, the likelihood that either would be imprisoned was low, assuming that convictions were obtained.

These objectives could only have been obtained via an extraordinarily lengthy, complex and chancy trial.

The results achievable by plea disposition, on the other hand, were clearly far superior. The issue was simply whether the prosecution of two mid-level individuals, who had not personally gained from the fraud, was of sufficient importance that it warranted accepting the enormous litigation cost and risks that a trial would require rather than the immediate and dramatic benefits provided by the terms of the disposition. Our assessment was that the terms of the plea bargain accomplished such a high percentage of our enforcement goals that it should be accepted.

The Criminal Division policy regarding the prosecution of corporate officials and employees for acts of wrongdoing is that corporations act through individuals and, therefore, individuals must be held accountable for corporate actions. That policy, when placed beside the facts, uncertainties and legal ambiguities of this case, would, if inflexibly applied, have forced us to reject a plea agreement that in many significant ways accomplished more than we could have achieved by a trial. In addition, it would have saddled us with a trial of unprecedented difficulty and high risk. That policy, however, is an important one and is sacrificed only when there is an overriding interest in doing so. The benefits derived from the Hutton plea were so substantial that they clearly warranted an exception to our policy.

The judgment in this case was most heavily influenced by two factors: first, Messrs. Murray, Clark, and Ogren viewed it as absolutely essential to obtain an injunction that barred the full range of Hutton's overdraft practices including the use of the draw down sheet and its multiplier. Hutton had made clear to us its intent to continue its draw down practices involving the use of the multiplier without disclosure to its banks. Hutton further indicated that it was computerizing the process to make it more efficient and uniform throughout the firm's operations. Second, the practices Hutton employed are believed to be wide spread and to cause large interest losses to banks, which posed the threat to inflict huge losses on banks if the overdrawing broker or business failed. Because of Williams, and under the facts of this case, these practices could not be reached by an indictment. However, an injunction, based on the bank fraud statute that overruled Williams, would provide a visible enforcement vehicle.

We ultimately viewed our choice as one between an uncertain prospect of convicting two mid-level individuals who did not gain from the fraud against the certainty of a broad based enforcement stroke that could immediately wipe out cash management abuses throughout the business community.

Conclusion

Based on the foregoing assessment, Messrs. Ogren, Clark and Murray recommended that the plea bargain reflected in Plea Agreement filed with the Court be approved. The key elements of the disposition are:

1. Hutton guilty plea to 2,000 Counts of mail and wire fraud. Fine of $2,000,000 (the legal maximum).

2. Hutton payment of $750,000 in investigative costs (not otherwise recoverable).

3. Hutton make full restitution, plus interest.

4. Hutton take a series of actions to inform and educate its employees in order to prevent a recurrence of abuses.

5. Hutton consent to an injunction that prohibits arbitrary overdrafting, chaining, use of multiplier or formula, criss-crossing and requires full disclosure of its cash concentration practices to its banks.

The disposition was approved by Assistant Attorney General Trott. Following action by Hutton's Board of Directors, Hutton entered its guilty plea and consent to the injunction before Chief Judge Nealon on May 2, 1985.

The **Chairman**. Just a minute. Let me ask you this, now: You were the Assistant Attorney General of the Criminal Division at the time this occurred, were you not?

Mr. **Trott**. Yes, I was.

The **Chairman**. This is the gentleman that handled the case in the department?

Mr. **Trott**. Mr. Murray is the original assistant U.S. attorney who was assigned this case many years ago and who, for a number of years by himself with the Postal Inspection Service in Pennsylvania, conducted the investigation involving over 300 subpoenas and 7 million documents.

The **Chairman**. Fine. Mr. Murray, we would be glad to hear from you.

STATEMENT OF ALBERT MURRAY

Mr. **Murray**. I am overwhelmed that I am here before the Senate. I am very personally honored that I am before the Senate, and my family who is here, my father and mother, I am sure I am speaking on their behalf, we are very honored. And I am also honored that I spoke in front of the U.S. House of Representatives also, and I am just a line assistant from Scranton, PA, and I never expected in my wildest dreams or imagination that I would be doing what I am doing. I hope I can testify today and illustrate the uniqueness of this case and the effort that it took to prosecute this case and that it was in fact a correct decision as to what we did in trying to represent the people of this country.

The **Chairman**. Incidentally, is this your first appearance before a committee of the Senate?

Mr. **Murray**. Yes, it is.

The **Chairman**. All right. Just proceed. You are doing just fine. You need not be nervous at all. Just take your time now.

Mr. **Murray**. I have a big glass of water right here.

Senator **Biden**. He probably never thought he would appear before Strom Thurmond, I can tell you that. [Laughter.]

The **Chairman**. It is an honor to have such a distinguished lawyer and attorney to appear here at this time.

Mr. **Murray**. Thank you very much.

The **Chairman**. And do not forget, you are appearing before Senator Biden, the ranking member, too.

Mr. **Murray**. Thank you, Senator.

The **Chairman**. You go ahead now.

Mr. **Murray**. Let me say this: I also want to thank the Department of Justice for having the confidence in myself and also John Holland who is back here, the Postal Inspector, to allow us the freedom to go before these committees, because I know it is not really something that is ordinarily done. And I appreciate the fact that Mr. Trott, Steve, as I call him, and Bob and Peter Clark have allowed me the opportunity, without any influence on their part, to tell you what the truth is and what happened.

I can only say this: This thing started early in 1982, in May 1982, when John Holland and myself and a group of postal inspectors thought to look at Genessee Country Bank. In Batavia, NY, we started to look at account No. 0406590017, I think it is. And then we looked at United Penn Bank, No. 317993. And we looked at the transactions that were occurring in that bank.

At that time we had no idea of the magnitude and the scope of this investigation. Ultimately, in the end result, we think we have changed the course of corporate banking and finance in America, something that maybe the average person like myself may not really see because it is operating really underneath the skin as the lifeblood of our country.

One of the problems, though, that occurred right from the beginning—and I am painting myself with the same brush—is that many lawyers and accountants and regulators did not grasp what cash management and corporate management was in this country. There were no definitions and no standards and no dialog between those various professions that would in fact be an interlocking type of a thread or fabric that weaves the way in which millions and billions of dollars go across this country.

If anything, as a result of this cash management practice and, really, misunderstanding of what cash management is, there were holes in that fabric which weaved those billions of dollars across this country. What happened after 2 years or 3 years, as we started to see, we were not just trying to enforce a law, but we were in fact writing the script as to what cash management was and the standards that were going to be in the country for cash management.

In fact, what we were doing, we were really weaving that fabric. We were trying to in fact weave the threads of cash management so it would fill those holes.

John and I and about 25 postal inspectors were attacking a massive industry. And in fact, what we had to do ultimately, at 3 and 4 o'clock in the morning when we would discuss this case and decide what we wanted to do, what we would do is we would think ultimately we have to then get an industry leader in order to effect the change that we wanted to occur. And that industry leader was E.F. Hutton; not merely one or two persons that represented E.F. Hutton but E.F. Hutton, the corporation that has represented 17,000 persons, not just one or two. And we wanted to hold up as an example the corporation.

For the past year-and-a-half, I have seen all the criticism in the press and the various things that have been going on, and I am rather amazed by it because this was not a conventional type of a case. It was not a bounced check case. It was not a robbery case. It is not an embezzlement case. The analogies do not apply. And it was not a narcotics case or an organized crime case or a public corruption case or a case involving a two-man corporation. It was a case that involved the collective intent of an entire corporation. That is what it was.

As a matter of fact, I might just indicate how it differs from being a robbery case or violent crime. For instance, understanding cash management, we fall into the very nebulous and outer limits world of such terms as mail float, logistics float, return float, intraterritorial transitional float, clearing house versus Federal funds, zero day money, negative uncollected positions, collected overdrafts vis-a-vis ledger overdrafts, gross overdrafts, secured overdrafts, collected funds versus available and good funds, net earnings profit credit, provisional debits and credits, disbursement versus collection techniques such as prefunding, estimated funding techniques, controlled disbursement, anticipated income. We are talking about double bumping techniques. We are talking about CEA offsets, and we also get into the terminology of CIPC's, RCPC's, ACH's, VCC's, APPC's, EFTS's. That is all involving one simple three-character phrase, and that is DDA, a demand deposit account—a checking account. This is not the typical bounced check case involving an individual. It is just not.

But one of the major problems in this case, and what I hope may come out of this hearing, is the victims, and the victims, the alleged victims, I might call them also the coconspirators were the banks involved in this matter. Because what this was was a relationship between two knowing parties regarding their profit.

We had a situation where almost the banks became hostile witnesses, where they became, in essence, coconspirators by reason of the fact that they knew or they should have known the activity that was going on. The problem in dealing with individuals is not just the fact that they are high level; that has nothing to do with it. What we must do, what I took the oath to do in Scranton, PA, in 1980, January 14, 1980, was to prosecute vigorously and to prosecute regardless of whether or not somebody was wealthy or they were poor, or they were white or black, or whatever. And based upon certain standards that we set in that we could prove a case beyond a reasonable doubt, not necessarily that because a person is a Robert Fomon or a George Ball, that we should reduce the standards because they make a lot of money. I could not do that and I would not have done that. It is just not justice, and it is just not what I took my oath to do.

The critical questions probably, and maybe I am anticipating too much, have to do with immunity. In the investigation how many did we grant? We granted approximately 57 immunities, but based upon an overall catchment group of 2,500 people.

One of the strongest and most striking bits of material that negated intent in this case was the fact that Hutton had the means allegedly to pay these items. Therefore, it was necessary to prove that in fact these individuals had the intent to commit a crime, that they could appreciate the criminality of their conduct when we are faced with an industry that is basically in chaos. And I say in chaos because of the fact that out of all the witnesses we talked to, the bankers, the accountants, the lawyers, in the 7 years that Hutton was perpetrating this activity, there was not one complaint. You have Arthur Andersen, one of the largest accounting firms in the world, who did not complain to any regulators. You have the largest banks in the world who made no complaints to the regulators about the activities. As a matter of fact, at the end of the year most of the banks—Chemical, Manufacturers Hanover Trust, U.S. Trust, Bank of America—would write letters of commendation to E.F. Hutton.

Now, whether or not there was economic blackmail, it is a knowing relationship between the two. Now, that is the relationship that a wedge needs to be drawn. That is where the dual standard is.

If I may just digress a minute, where the dual standard is is the fact that the bank, a bank who is the victim, they have the right to go to the enforcement agencies and say prosecute Al Murray or prosecute E.F. Hutton. And if they do not do that, then we as prosecutors cannot effectively prosecute the case. And where various regulatory agencies are saying and making decisions that in fact maybe we are interfering with the business relationship between two knowing parties that are contracting together for their business, then maybe that negates the intent. Maybe we cannot effectively prosecute that. And that is what we were facing in this case.

There is a love-hate relationship between the financial instutitions in this country, and, believe me, it was well and alive in this case. We had to drag people kicking and screaming into the grand jury because nobody wanted to admit that, in fact, they were defrauded. And as I talked to people even this week, the bankers and the accountants and some of the lawyers that rendered legal opinions to E.F. Hutton in this matter, they still do not know what they have done wrong. And the public still does not actually know what really went on in this case.

Senator BIDEN. That is why we are here.

Mr. MURRAY. I know, and I am glad to be here, Senator. As a matter of fact, I told Representative Hughes that I will stay here today, I will stay here until tomorrow, and I will stay here until next week, if I have to, to explain to you what happened and what went on.

What I would just like to say, and I know I am taking a lot of time, but I would just like to make this comment: That in entering the plea agreement that we did, and we were very much aware that the public is very cautious about plea agreements, because in fact it would be like there was some backroom deal or something deleterious about a plea agreement. However, in this case if we, as the prosecutive team, and I mean Steve Trott who is my boss, Bob Ogren, Peter Clark, John Holland, and the postal inspectors—if we considered politics, if we considered whether we were Republican or Democrat, if we considered favorites, if we favored the rich over the poor, if we were scared or intimidated or afraid to indict these people, if we were somehow intimidated by the fact that Hutton is a multibillion dollar corporation, if we want to avoid the unpleasantries of a trial, if we showed any bias whatsoever, or if we did not strike a hard enough blow for the American public, then we deserve your wrath and the wrath of the people of the country.

But that is not the case, and that is not what happened. There were no backroom deals. There was nothing that was improper or inappropriate about the handling of the case. If Al Murray did not do what everybody thinks he did not do, well, so be it. I think I am big enough to handle criticism. I do not mind that. But when we worked for the people of the country, when John Holland and my postal inspectors, I am kind of covetous of them, worked for 3 years, and they worked for one thing—not fame, not fortune—nothing but try to correct a wrong in this country, to expose the dual system of the banking system, to protect individuals, then I think when something like that happens, it is all we can do.

Our job is to represent the people of our country, not any one individual. And if we honestly, if we skillfully try to apply to collective experience of all of us and we critically evaluated the evidence toward correcting something that would affect the very lifeblood of our economy, then I think that is all we can do. And that is in fact what we did in this case. And I would do it again and make those recommendations again. I will do whatever is necessary for you that you want me to do or talk to people all over the country about changing the cash management system. I will stay here as long as you want to answer any question you would like.

Thank you very much for your patience.

The CHAIRMAN. I want to ask you this so that the issue may be clarified. Some Government people do not understand just what the issue is here.

What was E.F. Hutton tried for and to which they pled guilty? Please explain in simple words.

Mr. MURRAY. I am going to try to explain a very complex case as simply as possible. E.F. Hutton engaged in a scheme to defraud that was involving the intentional creation of float within the banking system of this country.

The CHAIRMAN. You are dropping your voice. We can hardly hear you.

Mr. MURRAY. I am sorry.

Senator BIDEN. Why do you not explain what "float" means.

Mr. MURRAY. OK.

The CHAIRMAN. Keep the microphone right up close to your mouth, and talk right into it.

Mr. MURRAY. Yes, sir.

Float is a system whereby a check is put in the process of collection, it is in the hands of one bank, and it is drawn on another bank, and is literally floating through the banking system and has yet to be collected by the various parties that are concerned. What in fact happens when you deposit a check in your bank drawn on another bank, it immediately becomes what is called cash items in the process of collection. That literally floats in the banking system to the extent where it is to be collected at the end source. That is called float.

What happens is you have various types of float. You have Federal Reserve floats; you have bank floats. There are different types of actual floats. What E.F. Hutton did, E.F. Hutton did not bounce any checks. They were charged with, in fact, engaging in a scheme involving drawing against uncollected funds or involved in what we call a collected overdraft position. There was nothing like where we would possibly draw against funds or write a check in anticipation of income and for some reason that check clears a lot quicker than we anticipated, and the bank might return that check. This is not the same type of situation. What Hutton pled guilty to was what we designed as a scheme whereby it was, in fact, utilizing a demand deposit account or a checking account as, in fact, a loan vehicle as opposed to a vehicle for the receipt for disbursement of funds. And that is what is indicated in the nationwide cash concentration system.

The CHAIRMAN. Do you want to get up and point out this chart? Will that help the situation?

Senator BIDEN. Is another way of saying it they used the bank's money without paying them "rent", paying them for the use of the money?

Mr. MURRAY. In essence, you might call it that. The only distinction is that in the event that a banking institution picks up the activity and can in fact process the check in time, it will receive what is called provisional credit from the Federal Reserve. In the event that it receives that provisional credit from the Federal Reserve Bank, then the bank in fact has not suffered a loss. And in this situation what happened, E.F. Hutton covered its ledger overdraft positions by a subsequent check. It gets kind of complicated.

The CHAIRMAN. By what?

Mr. MURRAY. With a subsequent check, with another check drawn on what we call a zero balance account. A zero balance account is what in essence is like a credit card. It allows the person that maintains the account to in fact extend credit by the issuance of a check when you actually have no money in the actual bank account.

Maybe what I might do, and I know time is of the essence, but I might explain the E.F. Hutton system how corporate cash management——

The CHAIRMAN. Go ahead. Do you have a pointer?

Mr. MURRAY. Thank you very much.

The CHAIRMAN. Why do you not stand around on this side?

Mr. MURRAY. All right.

The CHAIRMAN. That is all right now. Now, just stand back a little further, if you want to.

Mr. MURRAY. It kind of curves around and it will be hard for me to see it.

The CHAIRMAN. Hold that to your mouth so we can hear you, the microphone there.

Mr. MURRAY. All right. This is basically E.F. Hutton's corporate cash domestic financial network. What it is is broken down into basically ten regional areas, nine of which are domestic. What we have here, and it is not actually shown, but this represents approximately 400 branch offices throughout the country. What occurs on a daily basis is that money that is received by E.F. Hutton is first channeled in the various local branch offices, and then centralized in nine different regional locations at nine different regional banks, and then further funneled to two banks within the domestic cash concentration system.

One bank is Manufacturers Hanover Trust Co. in New York. Another bank is Bank of America in California. There is a purpose for that. The purpose for that is that in corporate cash management in the United States, the state of the art is to have two types of systems: one a disbursement system and the other one a concentration system.

What that is is like you and I have a demand deposit account, like a checking account, basically we receive income in that account and we also write a check and disburse out of that account. For large corporations what you have is the same function, but it is handled by multitudes of banks. So that the disbursement function, paying bills, the company acting as a payor of its bills and liabilities—the company used Bank of America to receive income from its various 400 offices throughout the country. It used Manufacturers Hanover Trust Co. in New York to receive that. That would be the concentration of money.

Now, what happens on a daily basis is that as Hutton pays a bill, obviously it needs what we call different types of disbursement techniques, like a prefunding technique. What they would do is when the moneys would be received in New York in the concentration system, they would balance it out and put money in the disbursement system and pay bills.

So what we have is a system of funneling money from these outlying areas, 400 areas, to the 9 regional locations in a concentrated method, and then, further, on 1 day up to the investment location, which would be Manufacturers Hanover Trust Co. So that Hutton could actually use their money, and any check that it would write to pay its bills or to pay its customers, at the end of the day Hutton would transfer money that it received from here, this location, to this location. The methodology of the transfer was through checks. Now, when we use a check, every single time we use a check to transfer money, we create cash in the economic system of the country. And every single time we do not collect that check quickly or promptly, that creates float in the system.

What happens in order to actually check that check, that check has to go through a series of collecting banks. And those banks going through that will give credit. What happens, ultimately what you have, what Hutton did, the first day that concentrates the money, it draws up. You are drawing up the income that it is entitled to, to draw it to use at Manufacturers in New York for investment.

The second day, because it is a check and it is what they call clearinghouse funds, it has got to clear the banking system. So what happens, the bank turns around and draws that money down. And that is what is called, what you will hear about, Senator, the Hutton's draw-down system. It was an attempt in order to centralize money in Manhattan for its use and to balance it off and pay its bills from these outlying areas. Mostly all corporate cash management systems in the country with retail branch offices has the same type of system of concentration.

Now, that was a very longwinded explanation.

Senator BIDEN. Mr. Chairman, might I say that maybe to put it even more simple terms—and comment if I am wrong about this—it is a little bit like you going into your bank in Charleston and depositing—or someone buying a product in your hardware store or you sell them securities, and they give you a check for $500. I give you the check for $500. You walk into your bank in Charleston, and you give them that check.

Well, until that clears, basically somebody else is using your money, using somebody else's money. At this time you should keep in mind interest rates are 18 to 20 percent. There is an impetus to concentrate a lot of money in one spot, was there not?

Mr. MURRAY. Yes, but not to necessarily concentrate it. There was an impetus to have the money made available to the company as quickly as possible in New York.

Now, one thing——

Senator BIDEN. So that they get to use their money rather than the bank.

Mr. MURRAY. Right. One of the problems in this case was, and where I believe the dual standard is, and what we were trying to do is stop that dual standard, where the bank profits from the situation. Because what happens in the system is that the Federal Reserve grants a 2-day provisional credit to any deposit of a check that is in the banking system.

Now, that provisional credit, that 2-day credit is different from us as individuals. We do not get that credit. A check may clear and it takes 6 or 7 days, but the bank is benefiting in 2 days on the money that is being deposited.

But, of course, we have to remember that the money that is being deposited, there should be an economic transaction behind that actual deposit. And here is what the problem with E.F. Hutton was. E.F. Hutton, in its aggressive cash management techniques, and I might add techniques that are approved and that are taught in accounting courses, that in fact the banks across this country offer the exact same services relating to float. And with regard to the fact that a float is something that is debated across the country as to whether anybody owns float, as a result of that you have E.F. Hutton using its aggressive cash management techniques to in fact inflate the amount of money that comes into New York for investment purpose, taking advantage of the check-clearing process.

Senator BIDEN. Is it not true that the inflation is OK if in fact it zeros out? The difference is whether or not, a little problem here, if it is just merely E.F. Hutton and other cash management proposals are designed to in fact see to it that it all balances out; that is, the bank does not make money on their money, but they do not make money on using the bank's money?

Mr. MURRAY. Well, that is true, but——

Senator BIDEN. The chairman asked you to do it in simple terms. That is ultimately the objective. People basically approve of that.

But when you go overboard and you decide not only are you going to be aggressive and then end up with zero, the bank does not make any money and you do not make any money, but go to the point where you are making money off of the bank, then that is what E.F. Hutton did here.

Mr. MURRAY. Yes. But you have to appreciate one critical point about this. In a trial this matter would have come out, and that is when a bank charges a service charge, $25, $30, its profit is in that service charge already. So any funds that are left in that account over and above the collected amount, over and above the compensating balances that would in fact cover that service charge, is profit to the bank and becomes excessive profit to the bank.

Here is what we have done by the civil injunction. What we are saying is that what ought to happen is that corporate cash treasurers ought to sit down with their banking institution and strike an agreement as to the amount of money that should be made not only by the bank but also by the corporate customer. Otherwise, we lead to abuses of which Hutton was in fact doing. Their whole theory during this case was that the banks were using our money. So if the banks were sticking it to us, we are going to stick it to the bank.

Senator BIDEN. That is right, as long as it evens out. But what I thought you all showed is that they went one step further. They said not only are we going to stick it to the bank until we come out even, we are going to stick it to the bank so that we make money on it.

Mr. **Murray**. Right. As a matter of fact, I can maybe explain that in the terms of——

Senator **Biden**. I understand it. I am trying to simplify it to make the point of what was done wrong here.

Mr. **Murray**. The problem is I just do not want to—in order to appreciate the complexities of the case so that the American public can appreciate the fact that it was a pie in the face to E.F. Hutton, you have to understand the complexities of it. And that is why I just want to, if you do not mind, indicate one thing.

What happened is that E.F. Hutton took the fabric of the system and saw holes in the fabric. There are studies that are done by Phoenix Hecht and all over the country as to where float exists in the system. A corporation can run its business without ever having a dime in the bank if it knows how to manipulate the float.

So what in fact Hutton did——

Senator **Biden**. Well, we do not have all that much time, Mr. Chairman. The way you would be able to do this with a jury is to sit down and say this branch sat down, they at the end of the business day received two checks from two people who came in and purchased securities and they get deposited. But in order to recapture the float that was in there, they took a check written on a New York bank that takes a couple days to clear, and they also deposited that in the local Scranton branch. And then they went to the regional branch, and they added up those total number of checks that were deposited, written on the Scranton branch, and they also brought in another New York check and put it in that bank account. It is not nearly as complicated as you say, but I do not have time and I do not think we should spend all the time without getting into substantive questions. I know you well enough, Mr. Chairman, what you are going to say to me. You are going to say it is now 5 o'clock, we have been here 2 hours, we have got to go and we cannot keep those people waiting. I have got 35 solid yes, no, maybe questions for Mr. Trott that I would love to get to at some point, and if you are willing to stay here, we can stay here as long as we need to. I am anxious to hear more; but if not, I would rather us move on.

Senator **Metzenbaum**. I would like to hear from Mr. Murray.

Mr. **Murray**. May I sit down?

Senator **Metzenbaum**. Be my guest.

The critical question to me is: You knew the facts, you learned the facts, you knew that Hutton profited by it, and at some point, either you on your own or in consultation with others, decided not to prosecute the principals. You could not have made this whole system work by just some local management. Somebody at the top knew, was involved, and I do not know why that person or persons were not prosecuted.

Mr. **Murray**. All right. Maybe I can try to answer that.

This was a money management practice that was being exercised for years. It was a process that went through a series of evolutionary trends in the money management. It was not something that individuals, Robert Fomor or George Ball, could appreciate the nature of the conduct. Because, in fact, their accountants, Arthur

Andersen, are reviewing this exact same system that we have here. In their work program—which I believe has been turned over to the Hughes committee—they state specifically this exact same system.

You have Federal regulators who have gone over Hutton's books, and in going over their books they did not question this activity. You had the SEC go over this activity; they did not question it. You had the banks who, at the end of the year, are writing laudatory letters to E.F. Hutton. And what the problem is you have to, from a criminal trial standpoint, prove that there was some notice in the mind of the individual that in fact what they were doing is criminally wrong. But I could not prosecute criminally Robert Fomon or anybody else based upon a negligence standpoint or they should have known or their management control should have been sufficient.

What we did is we developed the theory. These people that I mentioned did not approve, did not understand the criminality of their defense. Even though I wanted that to happen, it just was not the case.

The CHAIRMAN. We had not started asking questions yet. I had a few to start with.

Are you through with your explanation now? I just have a few questions I was going to propound?

Senator METZENBAUM. May I just finish that one question, Mr. Chairman?

The CHAIRMAN. All right. Finish.

Senator METZENBAUM. It is criminal to write a check without having money in the bank if your name is E.F. Hutton or Arthur Murray.

Mr. MURRAY. Albert.

Senator METZENBAUM. Albert Murray.

Mr. MURRAY. I do not dance. [Laughter.]

Senator, it is not criminal to write a check when you do not have money in the bank. If you want to know something, what that is called is playing the float and disbursement float. Many people across this country, and believe me, I am not saying that it is criminal, but many people play the float by writing a check prior to them having income in their bank account. What that is called is anticipating income.

What happens is that, for instance, where you expect to receive income on Monday but you have your mortgage payment due on Friday, you will write the check and you will play the float over the weekend. Now, technically you do not have money in the bank account. And what you are saying, to avoid the criminality and the crime, you are saying I know I have money coming in on Monday. That is my paycheck, and that is going to cover that check.

So that in fact, what you have done, in essence, is overdrafted your bankbook. You have what you call a book overdraft. But there is no bank overdraft. Because on Monday what happens, you deposit the income.

Now, if you really want to go to technical standards, when you look at Black's Law Dictionary, they define that as check kiting. I am not accusing anybody of doing this, but, I mean, as a practical reality of trial, I do not think any jury is going to relate to the fact that I pay my car payment a little bit ahead of time because I know I have money coming in. That is called disbursing float, and that happens all the time.

As a matter of fact, that brings up the point that Senator Biden was making. What was Hutton doing as a crime? What Hutton was doing is they were combining a technique of disbursement float on the collection side; in other words, instead of waiting, in cash management you try to delay.

The CHAIRMAN. Are you through now?

Mr. MURRAY. I was just waiting to answer Senator Metzenbaum's question.

Senator METZENBAUM. That is OK. Finish up.

The CHAIRMAN. I have a couple of questions to ask Mr. Trott. Senator Metzenbaum, I believe, has asked the first one.

Mr. Trott, another troubling concern has been raised about the propriety and potential impact of a luncheon of then-Attorney General William French Smith and Mr. Fomon, the chairman of the board of Hutton, immediately before the decision was made to extend the grand jury proceedings for an additional 6 months in November 1984.

What was your reaction upon learning of this meeting, and what impact do you believe it had on the decision to extend the grand jury as desired by E.F. Hutton?

Now, I want to say this: Personally I have the utmost respect for Mr. William French Smith. I am asking this question because it has been raised, and I felt it should be cleared up.

Mr. TROTT. Mr. Smith went to a luncheon which I believe he thought was going to be a personal luncheon. At the end of the luncheon, I was later advised that Mr. Fomon attempted to bring up the fact that there was an investigation in the Department. I was advised that Mr. Smith was taken aback by this and effectively, in a sense, gave Mr. Fomon a stiff arm and said that lawyers should talk to lawyers. That was the end of it.

It was reported to me, and it had absolutely no effect on the handling of the case whatsoever. All operating decisions in the case were made by the career lawyers. That luncheon might as well have been a tree falling in Canada with nobody there to hear it. It made no noise and had no impact.

The CHAIRMAN. Knowing Mr. Smith as I have known him, I thought that must have been the case.

Mr. TROTT. Mr. Murray might like to add a word if anybody tried to influence his handling of the case.

Mr. MURRAY. Oh, I loved it. I thought it was the best thing that ever happened for our case. And I believe John feels the same way, because it gave us credibility.

There is a certain amount of snooze factor to this case and glassy eye to this case because this is not a very sexy case. It is a boring, tedious case. And I thought it was a very complicated case, and John Holland and myself and the postal inspectors were trying to convince the Department of Justice that it was not going to be so difficult that we should, you know—there were changes that needed to be made, and we should prosecute the case.

Up until then, I had the attention of the Department of Justice, and in all due deference to Mr. Fomon, I think when he made that move, it highlighted Scranton, PA, and the prosecution that we had in that this was an important case, to shake the tree to the fact that the chairman of the board of Hutton is going to do a circumvention and try to talk the Attorney General out of us prosecuting something? That was the greatest thing that could have happened to our case.

The **Chairman.** In other words, it elevated the importance of the case.

Mr. **Murray.** Yes, indeed, it did.

The **Chairman.** Now, Mr. Trott, what problems did you face when formulating a legal theory upon which you would base your indictment in view of mail and wire fraud law at that time? And did changes in law, such as sections 1344, 1345, title 18, which were part of the Comprehensive Crime Control Act of 1984, improve the Justice Department's ability to prosecute fraud? And what further improvements in the law do you feel are necessary?

Mr. **Trott.** Mr. Chairman, I think the best person who can answer that question is Robert Ogren, the Chief of the Fraud Section, who was assigned to work with Mr. Murray on this. We had considerable problems on the basis of a Supreme Court case and a third circuit case that caused us a lot of problems. Bob Ogren can explain that.

The **Chairman.** Do you understand the question?

STATEMENT OF ROBERT W. OGREN

Mr. **Ogren.** Yes, I do, Mr. Chairman.

The **Chairman.** All right. You may proceed to answer it.

Mr. **Ogren.** Unfortunately, until October 12, 1984, we had a problem with respect to applying mail and wire fraud law to check kites or, although this was not a conventional check kite, an overdraft situation. The reason was that the Supreme Court in a case demoninated United States against Williams had taken away the overdraft check as a misrepresentation of amounts on deposit.

Senator Metzenbaum raised the issue of whether or not an overdraft check was illegal. Not only normally is there an intent problem connected with that, but the Supreme Court squarely ruled that that was not the case. That was the law as of October 11, 1984.

The third circuit took the *Williams* case, which was decided in connection with one of the banking statutes, a key banking statute, and extended it to the mail and wire fraud statutes, which were the other commonly used vehicles for prosecuting check kites, and essentially read the *Williams* case into the mail fraud statute. It left a little room for maneuvering but not a whole lot.

We felt that the kind of theory that Senator Metzenbaum advanced—that is, that an overdraft is inherently criminal—was squarely not the law. And we thought that that ought to be corrected to some extent, at least, and as you recall, Mr. Chairman, it was the position of the Department of Justice that it would be wise to enact what became ultimately section 1344, the bank fraud provision, as a cure to that problem.

Then section 1344 was enacted; it did not have retroactive effect. It has prospective effect and was useful, and we felt we could use it in the injunction. We ultimately did. But it left us with the problem of trying to craft a theory that would fit within existing law, and we came up with the theory that Mr. Murray described for you a few minutes ago; that is, that we treated this as a case in which there was a fraud on the banking relationship; that is, that Hutton had established banking relationships in which they had created accounts that were to be used for customer money, and to the extent that that was a lie, they had not used customer money, but they had really been rotating checks through there in a high velocity manner, that that would be a crime in and of itself. And it was that theory that we ultimately adopted, a far narrower one than had been possible, say, in 1980 or a far narrower one than is now possible under the existing law of section 1344.

The CHAIRMAN. Now, I have three questions I want to ask Mr. Murray, and then we will pass on to some of these other gentlemen.

First is, Mr. Murray, it has been alleged that the Justice Department in Washington became involved in this investigation at a crucial time and essentially took over the investigation and ultimately thwarted your intention of bringing criminal actions against certain individuals at E.F. Hutton. What is your reaction to that allegation?

Mr. MURRAY. Well, one, I asked for the help of the Department of Justice. I asked David Queen. We were at a point where we needed assistance from the Department to assist me in prosecuting the case. That is one.

The CHAIRMAN. Mr. Queen was a U.S. attorney?

Mr. MURRAY. I am sorry. He was the U.S. attorney.

The CHAIRMAN. He was your boss?

Mr. MURRAY. Yes. He was my boss at the time.

The Department of Justice aided me; they in no manner influenced me to change my decisions on the manner in which I recommended the disposition of this case—in no manner either implicitly, explicitly, there was no pressure, political or—nothing brought to bear on me regarding this. It was my feeling that based upon what Department policy is, if it is fair and just, we seek to prosecute not only corporate defendants but also individual defendants. That is always our policy. That is what I was taught to do from the time I first became a prosecutor in 1974. And that is what the intent was in this situation.

As a matter of fact, Mr. Chairman, we had the authority, Mr. Trott gave us the authority to go and proceed against individuals. But it was our considered opinion that we just could not effectively prove criminal intent against these people. And I was never, never, never influenced. And I was, as a matter of fact, very pleased that the people that I worked with were experienced and, forgive me for saying this, not maybe the Washington types that are into books all the time and not into practically knowing how to try a case.

The CHAIRMAN. Now if you all will make answers as briefly as you can, because we have got to move on.

Mr. MURRAY. I am sorry. Forgive me.

The CHAIRMAN. Either you can answer or Mr. Ogren can answer this.

As a line prosecutor, are you satisfied that the laws in the area of fraud are adequate for a successful prosecution of criminal fraud?

Mr. OGREN. I am not sure I can give you a succinct answer to that, Mr. Chairman. I think we benefited enormously by the enactment of 1344. I just wish it had been there earlier. And we have benefited enormously by the injunctive proceedings.

There are——

The CHAIRMAN. The provision you are speaking about is in the omnibus crime bill?

Mr. OGREN. That is correct, Senator.

The CHAIRMAN. That is the one that got in a bind and all of us got passed 2 years ago.

Mr. OGREN. We are deeply appreciative of having those tools today. There are other provisions that we would like to see enacted. I know today's hearing relates to the Hutton situation. This case is an example of trying to find a vehicle that will fit into the tricky contours of the law.

The fine of $2 million, for example, was a fine that was created on the body of 2,000 counts of $1,000 maximum fine each. Today we have a maximum fine that would apply which would be about $1 million, except for the doubling of the gross gain provision. That is grossly inadequate.

Incidentally I am speaking for myself now. I am not speaking for the Department of Justice. This is Bob Ogren's views of where we ought to be. Our fines are too low.

The injunctive provision which we were able to use is a great potential creative weapon for law enforcement. That injunctive provision is narrow. It ought to be extended beyond mail/wire fraud and bank fraud to the entire area of defense procurement contracting and give the courts the power to control in that area. We do not have a decent law of corporate probation, and we had to invent something that was the equivalent of that here by the use of the injunctive proceeding. It is about time that we had a provision that dealt directly and affirmatively with a concept of corporate probation in our laws. We do not have it, and it is something that I think, frankly, the time has come to deal with it.

There may be ways in which the bank laws could be improved. It would help enormously if we had a wire transfer system that did not cost 10 bucks a shot every time you wanted to create a wire transfer in this country, because Hutton had a dollar reason, a cost of doing business reason, for not using wire transfers; and if they had, they would have never perpetrated the scheme that occurred in this instance.

So, Senator, I have not come here prepared with a full list or a laundry list, but if you will give me 24 hours, I could probably treble or quadruple what I have given you in these few moments.

The CHAIRMAN. If you look into that, make any suggestions to the committee that you feel are not covered by law now.

I want to ask you this: Did you encounter difficulties in drafting the indictment against E.F. Hutton under the law in 1983 and 1984? And then I was going to ask you what suggestions could you advance about those gray areas of money management factors that Congress might focus on in future legislative efforts?

Mr. MURRAY. I will try to be brief.

So far the Federal Reserve System and the Board of Governors is uncertain as to who owns the float within the banking system. Part of the problem with this entire case has been who owns the float. In my opinion, what we were trying to do, is to have sweeping mass changes of the banking system. That is what we worked for. Basically float should be nonexistent, in that the collected funds should be the only vehicle that should be moved across the country.

In trying to develop this case, that is one of the reasons we could not have criminal intent against the individuals, because of the fact that the system, the corporate systems that are working today are based upon the aggressive management of float. And until float is defined by Congress or—I don't know who—Federal Reserve or whatever, you are going to continually have a competitive nature of America and businesses to go after float.

Back in 1979, there were approximately $6.9 billion of float, and the Federal Reserve could not identify the location of the float. Thank goodness for the 1980, I believe it is the Monetary Control Act, which now, as of July 1983, they are pricing the float to the banks. But what happens to the public is when the Fed then transfers $6 billion from its books to the bank's books, the banks are transferring it to you and I in the cost of services to us individually.

Mr. TROTT. Passing it on to the customer.

Mr. MURRAY. Passing it on to the consumer. And what I am suggesting is that what happens is that float be defined and that float itself not be priced back to the consumer, but be priced back to the person or individual or entity that creates it. It affects our economy, it affects the Ml, it affects the monetary reserves and aggregates, and it is a negative effect.

However, the banks do not know what to do with float. Some charge it as a nonearning asset; some charge it as an asset; some charge, some do not. There is no consistent policy.

Mr. TROTT. There has been a furious float fight for years. When we first talked to E.F. Hutton, one of their defenses was that the "banks have been doing this to us for years; now we are doing it to them." That was kind of the attitude that we saw. So Mr. Murray is right. As long as that float is there and as long as you are paying interest on money that is being used, there is going to be a wrestling match over who gets it.

Mr. MURRAY. If I might just add, the problem, again, in the prosecution of this case, was a jury nullification issue, that maybe we could prove we had a technical violation based upon our scriptwriting of a scheme to defraud, however, we could not have shown practically there was any actual loss to the bank, because the banks participated in the conduct, many of the banks participated in the conduct. The banking institutions that did not participate in the conduct monitored the activity on a daily basis; it was a hands-on partnership between the two. And they would have been guilty of negligence.

Senator METZENBAUM. Mr. Chairman, I am concerned. We are getting into an esoteric kind of discussion of bank float; whereas, the real issue has to do with a scheme where they devised the scheme and artifice to defraud and obtain money from various banks and financial institutions with which Hutton had established depository relationships. We are talking about float as if we are going to start suddenly move into the economics of banking and investment banking company relationships. If we are going to keep our——

Mr. MURRAY. If you do not mind, that is what the case is all about.

The CHAIRMAN. Let him finish his point.

Mr. MURRAY. I am sorry.

The CHAIRMAN. In a few minutes, he will be able to ask you about it. I just have one more question and then I will pass it on to them.

Now, what do you believe the impact of the E.F. Hutton plea agreement and civil injunction will be on money management techniques in the large brokerage houses such as E.F. Hutton? And how widespread do you believe some of these practices were in the other brokerage firms before your investigation of E.F. Hutton?

Mr. MURRAY. Yes, Mr. Chairman. One, I believe the impact is going to be this—and I just got finished talking to what I consider to be one of the experts in banking and finance on Wall Street on Monday. I asked him after a year now of going through all this what impact has happened.

He explained to me that it has changed irrevocably the relationship that the bank has as one of the ten largest banks in the world with their corporate customers and clients. They are now monitoring the float where they have never monitored the float before. They are entering into agreements with their corporate treasurers. They finally are looking and opening some of the closets they have had and looking at the business relationship among their most trusted customers who maybe might be having one arm around their shoulder and the other one in their pocket.

I believe that cash management will change because, hopefully, while we have not actually changed the law, we have changed the theory of prosecution; now, the Department will find schemes to defraud such as this, where the gray area is now, that fabric, tear line is no longer in the middle, it has now gone over the edge, we will now look very closely at prosecution.

Now, as far as widespread, I think that it is widespread that corporations try to obtain the float. The individual techniques and manners and methods in which they do it may vary. Like Hutton used the chaining techniques, where it strung deposit locations or they used excessive overdrafting, that is one form of trying to create float. Other companies may do it a different way. They may put a staple in a check. They may put vaseline on the microencoding lines and create a day float. They may bend the corner of the check and put maybe a piece of tape on it so that it kicks out and has an extra day's float on the item. There are multitudes of techniques. What the evil is, is the thought that we are allowed to create float in the banking system, and that as a result of the gullibility of the bank, we can get money that we are not entitled to.

The CHAIRMAN. All right. Now, I am going to turn to the distinguished ranking member.

Senator BIDEN. I would like very much to continue the discussion about floats, but it is going to take up all the time. If we have time, I will come back because I could not disagree with you more. And I have spent the last 2 months learning about all that you have learned about. I think you are wrong, but I will get back to that in a minute.

I would like to ask just for the purposes of the record to put in the record a memo dated April 23, 1982, from Mr. Perry H. Bacon to Mr. Steve Braylove, which does not answer all the questions but it is just appropriate at this point in the record. And I will get back to it later.

The CHAIRMAN. You want to put that in the record?

Senator BIDEN. Yes, if I may. Actually, it is in a series of documents. We will make a copy of it. It is only two pages.

The CHAIRMAN. Without objection.

Senator BIDEN. It is just bound up in a whole lot of other things.

The CHAIRMAN. It is two pages. Without objection.

[Information follows:]

EF Hutton
INTER-OFFICE MEMORANDUM

TO : Steve Bralove
FROM : Perry H. Bacon
DATE : April 23, 1982
SUBJECT : Your Memo - Banking Activities

Our banking activities during the last six months have been no different than our banking activities off and on for the last five years. Additionally, I believe those activities are encouraged by the firm and are in fact identical to what the firm practices on a national basis. Specifically, we will from time to time draw down not only deposits plus anticipated deposits, but also bogus deposits. One day prior to that incremental drawdown arriving at our bank, we may need to cover with a New York (Chemical, U.S. Trust) check. As long as the local bank honors that check with same day availability, the firm profits at both the branch and the national level. We profit at the branch level by creating a surplus in general ledger revenues which are credited at the broker call rate. We profit at the national level for two reasons: 1) Because New York is doing the same thing with the U.S. Trust check by reacting to our bank wire and floating checks based on those deposits which deposits may not really exist. 2) Because those bogus deposits create a reduction in our net capital ratio requirement which allows the firm to deploy capital elsewhere. Furthermore, we (as a firm) learned to use the float because it is exactly what the banks do to us (see enclosed article). I know of at least a dozen managers at E. F. Hutton - managers who along with Bill Sullivan and Tom Morley taught me the system - who do precisely the same thing. Presumably, any manager who was willing to take the time to learn the system would want to use the system.

The obvious drawback to the system is that it can cost the bank money. If the bank honors a New York deposit check with same day availability and subsequently have those funds withdrawn by a New York drawdown check before they get FED usage of the funds, they have a net debit. On the other hand, the bank is not quite the defenseless amoeba that your memo suggests. FIRST, the system only exists because, peculiarly, our mammoth federal banking system is more hand processed than automated - NB - a system which the banks well know how to use as the enclosed article discusses. SECOND, the system we use does not happen the day we open an account. We spend months working up to larger drawdowns leaving the bank surplus deposits, and I do not recall any bank offering to send us their earnings on those deposits.

NB - There is not much difference between what we do and when a bank tells you not to write checks on your out of state deposit for 10 days, clears that check through the FED in 2 days and enjoys the float for 8 days. Essentially, the bank has created a net debit against you in the form of 8 day nonusable funds. By the way, Tom Morley believes that within 2-3 years the entire system will be automated and all domestic checks will clear in one day. Therefore, as Tom stated in our New York BOM meeting, the time to take advantage of the system is now. (See second enclosed article.)

THIRD, all banks either now know or eventually figure out our system. When they do, they simply cease giving same day availability, and often will not court regular checks as collected funds. In fact, contrary to your implication that all banks are now holding your checks, NBW (a bank with whom we have never dealt) had been doing that to you months before this issue arose. FOURTH, if a bank is slow to move on #3 above, documents a net loss and asks us for same, we will probably give it to them. Our objective is not to steal money from the banks. Whatever the bank may have lost, we have enjoyed a greater profit due to the spread float.* I am aware of four branches that have had to write checks within the last six months for just the reasons listedabove. On the other hand, many banks accept their losses as a cost of doing business and never ask for the money.

This last point leads to some of the specific remarks in your memo. FIRST, when you called a few months ago and asked if I was aware that due to our overdrafts, 1st American was giving you trouble with your secondary account there, you will recall that I replied that I was not aware, and I replied that I would not do any more overdrafting at that bank. If I sounded unconcerned, it was because your terse interrogatory was limited to your secondary bank account. The first time I heard about an institutional problem was from Ernie some weeks ago. Your conclusion that my attitude to Hutton's reputation in the city is "indifferent" is ridiculous. I confess to an emotion somewhere between indifference and astonishment at your suggestion that the solution to your secondary account problem was to call and offer money to a bank that had not, and to this date has not called me to complain, ask for money or request to discuss the issue - in fact has never called me at all. SECOND, your remark that since 1st American has contacted all of the area banks and now all banks are holding checks is not only contradicted by your knowledge that NBW had already been doing that, but would further suggest violation of any number of federal and banking statutes regarding collusion and anti-trust. THIRD, and what really troubles me, is that your constant use of terminology such as "excessive," "blatant disregard," "casually damaged" and "indifferent" is way out of line - and I think you know it. I plead guilty to simply never having considered that an institutional relationship could be jeopardized. Importantly, if our zeal with the bank has in any way impaired your ability to do business with that bank, I am genuinely sorry and would like to apologize to you and anyone else adversely effected. However, your sweeping implication that such an isolated incident immeasurably damages our reputation and ability to transact

*Ex. - the average balance that we earned on during the months to which you refer was significantly greater than the 2 million figure that the bank stated.

Senator BIDEN. Mr. Trott, you have answered the question of the Chairman about your assessment of the Fomon-Smith meeting.

Another question I have is you knew that E.F. Hutton had the resources of Cahill Gordon and Bill Huntley. Did that play any factor in your decision to settle this case in terms of their competence? I mean, as you sat down and figured, I have got to settle. You went through your rationale, which is essentially, as I understand it, shaky case, tough theory, complicated facts, goal of settling this thing to the best interest of the public; ergo, you did not feel you had as strong a hand as you otherwise would.

Was part of your consideration that you did not have as strong a hand that had those two attorneys on the other side?

Mr. TROTT. No.

Senator BIDEN. OK. Second question: When the E.F. Hutton matter was brought to your attention, what was the legal theory you were proceeding on at that time? When it was brought to your attention, Mr. Trott, what was the legal theory the Justice Department was proceeding under at that time? Was it fraud, mail fraud, wire fraud?

Mr. TROTT. It was essentially mail fraud and wire fraud, was what we were talking about as the core of the prosecution from the beginning. Other things were touched upon, but that was the core.

Senator BIDEN. How did you evaluate the probability for success of your theory, your legal theory, if tested in court? How did you assess the probability? Your colleague talked about the *Williams* case and the impact of the *Williams* case upon the theory of representation and whether or not it constituted a fraudulent check—as a representation—or was not a representation? How did you evaluate the probability of success?

Mr. TROTT. You mean on a scale of 1 to 10, good, medium, bad, however you do it. We thought that we had a theory that was valid, but that it was a very problematical theory that could easily result in a legal defeat or a jury defeat. It was not an open and shut case by any stretch of our collective imagination.

Senator BIDEN. Did that play a role in your decision to recommend that the case be pled out, that it be settled, negotiated?

Mr. TROTT. Yes. Our assessment of the strengths of the legal theory and of the case did play a role in our assessment of how it ought to be settled.

Senator BIDEN. Did you believe that you could only try part of this scam or this imaginative aggressive system, which you ultimately concluded was a wrong thing being done, did you conclude that you could only try part of the scam in Pennsylvania?

Mr. TROTT. Yes. The team felt that you could not venue all of the national scheme in the middle district of Pennsylvania.

However, by settling the case, we could force Hutton to include all the victims nationally into that prosecution, and that is why we thought that was a plus factor.

Senator BIDEN. So that the venue problem—did that play a role in your decision to settle also?

Mr. TROTT. It was a minor consideration, I would think, but it was a consideration.

Senator BIDEN. Did you believe you could only stop the more egregious money management practices by a civil injunction under 18 U.S.C. section 1345?

Mr. TROTT. We believed that the practices that were included in the civil injunction were practices that could not be prosecuted; but by putting them in the injunction, we could draw the bright line that we were looking for for money management practices. That is a short answer.

Senator BIDEN. Through settlement?

Mr. TROTT. Yes. Through settlement, through the injunction, and we could do it right on the spot rather than 2 years later after battling this out in the courts.

Senator BIDEN. And you believed that you might have, yet you ran the risk of losing if you in fact had prosecuted?

Mr. TROTT. That is distinctly probable. And as a matter of fact, in some recent white collar cases, including one we talked about a couple of weeks ago in here involving a money laundering, we found that the juries once again were loathe to prosecute the individuals in the bowels of the scheme in favor of convicting the corporation. We felt that was a distinct probability based on past history and our assessment of the case.

Senator BIDEN. When it was brought to your attention, this case, Mr. Trott, for your decision, did you believe that any further investigation beyond what had been done at the moment you made the decision that we should in fact work to negotiate out a plea on this? Did you believe that any further investigation would develop additional evidence? Did you conclude at that moment that there is nothing else that I could reasonably do, there is no further investigation that could be taken that would lead me higher up the ladder in the *E.F. Hutton* case? Was that your conclusion?

Mr. TROTT. That was my understanding based on talking to the lawyers who were handling the case. Now, I want to make one thing absolutely clear. It is in my testimony. We had an option at that time of prosecuting individuals. They were not the types of individuals that everybody seems to have this appetite for, however. And I was advised all along the line in our conversations that we had exhausted our investigative opportunities, and that the top of the corporate ladder did not appear to be involved to the extent that we had the evidence that would hold up in court against them.

Senator BIDEN. And you concluded at that point that there was no investigative tool that was left unturned that could in fact, that would in fact likely change that decision, I take it?

Mr. TROTT. I was aware of none, and Bob, Peter, and Al, who had been working on the case, and John Holland were aware of none either. At least that was my understanding.

My only reservation here is that I was operating as a supervisor. I am not trying to distance myself at all because I agree with everything that was done. But the people who were developing the investigative opportunities were people other than myself.

Senator BIDEN. Oh, no. I do not doubt that at all, but obviously you became aware of the potential political sensitivity of this. I am not suggesting any wrongdoing. Seriously. William French Smith came out; obviously he understood the political sensitivity.

Mr. TROTT. Sure.

Senator Biden. He came to you and said, by the way, in effect, Fomon came to have lunch with me. I thought I was going to talk about golf or whatever, and be mentioned this case and I stiff-armed him. I just wanted you to know that. So from that moment on, you knew you did not have your ordinary garden variety case about whether or not you have got a thug who just pumped somebody in the street.

Mr. Trott. That is right.

Senator Biden. OK.

Mr. Trott. And I knew that we were going to catch heat for not prosecuting any individuals.

Senator Biden. Right. So obviously, at some point, you personally made a decision that, based on the recommendations and your faith and confidence in the people who had been developing the case up to this point, that there was no productive avenue of investigation which could further be pursued in order to lead you beyond the people you had already identified within E.F. Hutton Corp. as potentially personally criminally liable.

Mr. Trott. I accepted that recommendation, and I approved the settlement.

Senator Biden. Do you believe that the settlement reached was the best that you could have obtained for the victims and for society? I think you have answered it, but I want to get a sense of where you are.

Mr. Trott. On balance, I do believe that it was a good settlement and that it attained the objectives of our prosecution within the parameters of our general goals and objectives and rules and procedures. Yes.

Senator Biden. Did you consider the application to the facts of 18 U.S.C. section 2314, which prohibits the interstate transportation of property obtained by stealing or by conversion?

Mr. Trott. Maybe Mr. Ogren can give you that.

Mr. Ogren. Yes, we did.

Senator Biden. What conclusions did you reach?

Mr. Ogren. The application of that statute turns on the existence of a fraud. It presents essentially the same problem as the Williams case. We would have had to have proven a fraud that was prosecutable, and from our perspective, mail/wire fraud, ITSP really made no difference.

What I am getting to, Senator, is you do not——

Senator Biden. Oh, I know what you are getting to. That is where I want to get to.

Go ahead. Elaborate while I just run through my notes here to find the section.

Mr. Ogren. It really does not make any difference as far as we are concerned whichever one you proceed under.

Senator Biden. Whoever transports in interstate or foreign commerce any good, wares, merchandise, securities or money of a value of $5,000 or more, knowing the same to have been stolen, converted, or taken by fraud.

Mr. Trott. You go right back to the core problem: stolen or taken by fraud. No matter how you turn this case, you go back to float and the problems with the system.

Mr. **Ogren**. It is the same core problem, Senator. You have got to prove an intent to defraud.

Senator **Biden**. Let us pursue that a minute.

In the U.S. Attorneys Manual, title 9, the criminal division, section 9-61.248, stolen, converted, or taken by fraud is defined in the following way: The terms stolen, converted, or taken by fraud are intended to cover all forms of theft offenses regardless of whether such taking was in the nature of a common law larceny, embezzlement, or false pretense. The term covers the felonious taking or conversion of another's property right in a particular object.

Is that correct?

Mr. **Trott**. Sure.

Senator **Biden**. Were you aware of the *Evans* case?

Mr. **Ogren**. I am aware of the *Evans* case.

Senator **Biden**. Well, the *Evans* case dealt with this application of this pursuing, as I understand it, and give me a chance here. It has been a long time since I have tried a case. You guys have been doing this a long time.

Now, I may be wrong. I do not think so, though. The *Evans* case, the *United States* v. *Evans,* which was September 1, 1978, says——

Mr. **Ogren**. That is preWilliams, Senator.

Senator **Biden**. That is correct.

Mr. **Ogren**. All the law is different postWilliams, Senator.

Senator **Biden**. I understand you believe that.

Mr. **Ogren**. I hope that that is clear.

Senator **Biden**. By the way, comparing the *Williams* and *Evans* cases, let me just read the operative section.

The Evans challenge to the jury instructions on the definition, converted or taken by fraud. The trial court told the jury that converted meant to appropriate dishonestly or illegally to one's own use anything of value.

Now, it goes on to say that Evans contends that under section 2314 converted means only illegal taking. So he argues the trial court erred when it included the motion of dishonest taking.

Mr. **Murray**. Could I comment on that, please?

Senator **Biden**. Let me finish and then you can comment. OK?

Mr. **Murray**. Thank you.

Senator **Biden**. I am reading from page 361 of the case. The language of section 2314 reflects a congressional purpose to reach all ways by which an owner is wrongfully deprived of the use or benefits of the use of his property.

You have indicated, Mr. Trott—and then you can comment—in your opening statement that that is precisely what was done, that the bank was deprived of having the benefit of its money by giving an interest-free, unsecured, short-term loan, which is what Hutton got, and in the memoranda which has been put forward, that I put in the record, there is by Hutton's own admission——

The **Chairman**. Excuse me just a minute. I have another commitment on the floor to take up a bill over there. They are taking amendments to the U.S. Crime Bill, and I must leave. I want to express my appreciation to your witnesses here. I think you have done a fine job explaining your positions and what you have done. And the distinguished Senator from Kentucky is going to take over the hearing now. I will ask him to take my seat.

You may proceed.

Senator **Biden**. Thank you.

So that your contention, and I would like you to explain it, is that the *Williams* case overturned the definition of converted as set out in the *Evans* case; is that your contention?

Mr. **Ogren**. Senator, to be very clear on this score, you need to have an intent to defraud or you cannot get a conviction. Forget it. And if you are suggesting that you can——

Senator **Biden**. But you do not need a representation, do you?

Mr. **Ogren**. You have to have a theory of fraud, Senator.

Senator **Biden**. I understand you believe that. Answer my question.

Mr. **Ogren**. The question is you need a misrepresentation in order to have a fraud. The answer to that question is yes, you do.

Senator **Biden**. You need a representation.

Mr. **Ogren**. Misrepresentation.

Senator **Biden**. Do you need a representation in the way in which the Williams case used the term?

Mr. **Ogren**. No. Not the *Williams* case representation. In fact, we did not have one. We came up with another misrepresentation——

Senator **Biden**. I understand what you came up with. I just want to make clear what we are talking about.

Mr. **Ogren**. But the point I want to make about the *Evans* case is that the mail fraud law as we applied it was perfectly adequate. We did not have to go around looking for more difficult theories.

Senator **Biden**. You insist that if you proceeded under that theory it was more difficult?

Mr. **Ogren**. I think the *Evans* case would have posed more difficulty than the one we were successful on.

Mr. **Trott**. Senator, with all due respect, I am not sure what you are driving at, because we at all times felt——

Senator **Biden**. What I am driving at is I think you have miscategorized this offense.

Mr. **Murray**. May I just add——

Senator **Biden**. I am not asking you a question. Just let me finish my comment, OK?

Mr. **Murray**. Yes. Excuse me.

Mr. **Trott**. At all times we believed that E.F. Hutton as a collective entity was guilty of crimes, and that is why we told them you must plead guilty and they did. There was a crime.

Senator **Biden**. I am not suggesting to you that you did not think they committed a crime. I am suggesting to you that you viewed it as fraud instead of conversion, and it is a distinction with a difference under the law.

For example, if you had proceeded under the conversion statute, you would have had fines that were five times as much, you would have had the ability to jail terms. You just got finished telling us how important the need is for us to up the fine and up the jail term. You would have been in a stronger negotiating position, I would respectfully suggest, and your theory, I would argue, would be at least as strong, I would argue stronger.

Mr. **Ogren**. Senator, we considered the possibility of 2314 right down to the end on a fraud theory not on a conversion theory, which frankly I do not give much weight to. With all due respect, I disagree with you on that, sir. And I do not see a dime's worth of difference. And we came up with a theory——

Senator BIDEN. Assuming there was not a dime's worth of difference or they are the same, does it not give you some more leverage in terms of penalty? Five times the penalty does not give you more leverage?

What are you asking us to increase the fines for, then?

Mr. OGREN. Senator, we agreed that the fine was going to be $2 million, and then it was only a question of coming up with what number of counts were adequate to cover that which they had in fact committed.

We started with a fine, and we reached the number of counts from the fine. It did not go the other way.

Senator BIDEN. Why did you not start with $8 million?

Mr. OGREN. Pardon?

Senator BIDEN. Why did you not start with $8 million or $10 million or $12 million or $1 million?

Mr. OGREN. It was, we felt, the appropriate number.

Senator BIDEN. How did you arrive at that magical number?

Mr. OGREN. Well, we discussed it.

Mr. MURRAY. May I?

Senator BIDEN. Sure you can.

Mr. MURRAY. Thank you. And forgive me for interrupting if I did before. I get exuberant.

Senator BIDEN. Just answer the question.

Mr. MURRAY. OK. May I just comment on something you indicated about——

Senator BIDEN. Answer the question, please.

Mr. MURRAY. Let me put it this way: The banks could not determine the amount of the fraud or the amount of the fine. The Hutton records from 1981 and 1980 were inadequate to make that determination. The Federal Reserve could not determine the intricacies of the float.

The only thing we could do is make rough estimates as to the total amount involved in the dollar scheme, in the creation of principal, and also on the actual loss, plus one of the things that the honorable Senator said earlier had to do with the intricacies of float. If we could not prove that there was criminal intent regarding trying to capture the float or create the float, you would have no basis for proving a conversion. It all goes from the bottom to the top. And what you must do, as prosecutors we must deal with the intricacy of the actual instrument and its effect upon the bank and the victim, where the victim itself has said all through the course of dealing——

Senator BIDEN. That is not the law.

Mr. MURRAY. It is the law.

Senator BIDEN. That is not the law.

Mr. MURRAY. Well, I can just say this: With all due respect——

Senator BIDEN. You are telling me that you, the Government, can only make a judgment on whether or not a law has been violated based upon whether or not the victim suggests that in fact the law had been violated as you allege? Is that what you are saying?

Mr. MURRAY. No. No, I am not saying that. You have misinterpreted what I said, Senator.

Senator BIDEN. Say it clearly.

Mr. MURRAY. OK. I am sorry if I am not being clear. This is my first time here.

What I am trying to say is a situation almost like a person who is a rape victim or abuse victim. There may be a technical violation, the person may have in fact been abused, but we need the victim. We need the victim to say that in fact they have been abused. It is a matter of jury appeal, a strategy that prosecutors take into a jury room. We have to have a victim who is in fact a victim.

Under the mail fraud law, we do not——

Senator BIDEN. You did not find a single bank in the system that was——

Mr. MURRAY. Oh, of course we did. The Genessee Country Bank complained. United Penn Bank complained. But they complained on December 8, 1981. The activities that were in their accounts is the same identical activity that was in the Chemical Bank of New York, it was in the Bank of America, and none of those banks were complaining. And the reason why——

Senator BIDEN. Why?

Mr. MURRAY. You know why? There was a hands-on relationship between the bank and E.F. Hutton, because of the business relationship, because the fact of the matter is they wanted——

Senator BIDEN. You did not think you could explain that to the jury?

Mr. MURRAY. The problem is having the bank admit this was not a business relationship, that it was not the type of—that it was in fact a business relationship. We have to ask from the stand—let me give you an example of a cross-examination.

Mr. Banker, how long have you dealt with E.F. Hutton?

Six years.

Mr. Banker, were you aware of all the various transactions that were occurring in the account?

Well, yes.

Do you have people that monitor the bank account?

Yes, I do.

As a matter of fact, you do a profit analysis of that account every month, do you not?

Yes, I did.

Did you see the activity that was in the account?

Yes, I did.

And did you, in fact, allow Hutton to draw against uncollected funds?

Yes, I did.

Why did you allow that to happen?

Well, because E.F. Hutton has 5 billion dollars' worth of other business in my bank.

And, in fact, Mr. Banker, you knowingly permitted that to occur, did you not?

Yes.

Why? Because it was a credit decision; is that not correct?

Yes.

And, Mr. Banker, do you consider yourself to be defrauded?

No, I do not.

However, is it not kind of a shady, unethical practice?

Well, yes, it is.

Mr. Banker, why did you not complain to the New York State Banking Authority or the California Banking Authority about this activity?

Well, because it is E.F. Hutton, and I did not want to accuse E.F. Hutton of doing anything wrong.

And that is the problem. And when you argue that in front of a jury, I can just tell you as a prosecutor that it is a mighty, mighty powerful tool as a defense attorney.

Senator **Biden**. Well, let me tell you something. I think you are wrong, and let me tell you why I think you are wrong.

You go out and I steal your car and I steal his car and I steal his car. It really bothers him that I steal his car, that I damage it; it bothers you, you are a little guy, but I stole his car and, by the way, he owes me $500,000.

He comes in and I get all of you in there, and I say, now, were you hurt by the two little guys? He said yeah, I did not like it, I did not have an agreement with the bank like that. And now the defense attorney calls one of the people who were allegedly defrauded. Did they take your car?

Yeah, they took my car.

Why did you not complain?

Well, in fact, I owe him $500,000, and I was afraid if I complained that he stole my car, which I did not give him a right to do—and you are telling me that you could not make the case to the jury what E.F. Hutton was doing was wrong?

Mr. **Murray**. If I might comment to you——

Senator **Biden**. No, I do not want any more comments.

Mr. **Murray**. Well, if I can answer——

Senator **Biden**. You made your case why you thought it would not work. I made my case why I thought it would. Let me go on with my questions.

Mr. **Murray**. I just did not think we were adversaries on that.

Senator **Biden**. Let me go on with my questions.

Mr. Trott, I want to make sure I understand this. The penalty for mail fraud and wire fraud is $1,000 and 5 years per count; is that correct?

Mr. **Trott**. That is what it was.

Senator **Biden**. OK. That is what it was at the time. And the penalty for interstate transportation of property obtained by stealing or conversion is $10,000 or 10 years per count, right?

Mr. **Trott**. I accept that.

Senator **Biden**. Now, did you consider the application of criminal or civil RICO in the *E.F. Hutton* case?

Mr. **Trott**. I believe it was talked about for a very short period of time, but never pursued, at least by me.

Senator **Biden**. Could you have used RICO?

Mr. **Trott**. I am not sure. I never got into it that deeply.

Senator **Biden**. You signed off on the case, and you never got into it that deep.

Mr. **Trott**. That is absolutely correct.

Mr. MURRAY. May I comment?

Senator BIDEN. Sure. I want to know whoever got into it deeply. Did anybody get into it deeply? Did you?

Mr. MURRAY. Deeply, what?

Senator BIDEN. That is, the issue of whether or not you could use——

Mr. MURRAY. Oh, you mean civil RICO or criminal RICO?

Senator BIDEN. Yes.

Mr. MURRAY. Sure.

Senator BIDEN. OK.

Mr. MURRAY. As a matter of fact, one thing that aggressive prosecutors do is when they hear R-I-C-O, RICO, they initially want to charge everybody with RICO because they have the forfeiture provisions, et cetera. So what, of course, I wanted to do if in fact I could take away every single asset that E.F. Hutton had and used in organized——

Senator BIDEN. Tell me what you considered with regard to RICO.

Mr. MURRAY. Well, if I could use an organized crime statute against the company, it would make my case look a little bit better and it might look better to the jury. But as a practical matter, it was not applicable at the time and to the facts to use RICO.

Senator BIDEN. Why?

Mr. MURRAY. Because RICO is nothing but a vehicle based upon multiple counts of a substantive offense such as mail fraud and wire fraud, and that——

Senator BIDEN. Were there not multiple offenses?

Mr. MURRAY. Yes, there were multiple offenses, but to think that in fact I was going to get a court or a jury to in fact strip away and confiscate all the assets of E.F. Hutton, it was just not a practical conclusion.

Senator BIDEN. Was there an enterprise?

Mr. MURRAY. Of course.

Senator BIDEN. Was there in fact interstate commerce?

Mr. MURRAY. Interstate commerce was effected through the transfers of the checks and also through the wire's electronic function.

Senator BIDEN. Were there persons employed by the enterprise?

Mr. MURRAY. Of course. It is a 17,000-employee corporation.

Senator BIDEN. Was there a pattern?

Mr. MURRAY. Yes; but it does not really matter whether the vehicle——

Senator BIDEN. Will you answer my question?

Mr. OGREN. The answer on that was no.

Mr. MURRAY. The answer is no, not necessarily.

Senator BIDEN. The answer is there was not a pattern?

Mr. MURRAY. A pattern of criminal conduct? There was a vehicle of counts, but the whole thing went back to could you prove the fraud, Senator. Could you prove in fact there was a violation of the RICO statute? The vehicle means nothing if you do not prove the scheme.

Senator BIDEN. Will you please answer my question? If there was not a pattern, say no, there was not a pattern. If you think there was a pattern——

Mr. **Murray**. I am sorry.

Senator **Biden** [continuing]. Say there was a pattern.

Mr. **Murray**. I am trying to be as open and as truthful as I can.

Senator **Biden**. I do not want you to be open. Be closed a minute. Was there a pattern?

Mr. **Murray**. Am I talking too much? I am sorry.

Senator **Biden**. Was there a pattern?

Mr. **Murray**. I did not consider it to be a legal pattern that we could pursue.

Senator **Biden**. You did not think it was a pattern as required under RICO?

Mr. **Murray**. As required, in the case, yes. But I wanted to charge them with RICO. That was a part of the universe of charge—I am very, very sorry that I talked too much. I just want to be honest and open and as full and complete as I can with you. I am sorry.

Senator **Biden**. If you had concluded that RICO was applicable, would that have solved your venue problem? Yes or no. If RICO had been applicable, would it have solved your venue problem, Mr. Trott?

Mr. **Trott**. I do not know.

Senator **Biden**. You do not know?

Mr. **Trott**. No.

Senator **Biden**. Why do you not know?

Mr. **Trott**. Because I do not know. I would be happy to go back and talk to our RICO experts to give you an analysis of that, but sitting at the table I am not going to tell you I know when I do not.

Mr. **Ogren**. Senator, there are two ways in which it does not solve it. It creates another offense, but it does not solve the restitution problem——

Senator **Biden**. I did not say that. Will you answer my question? Would it solve the venue problem?

Mr. **Ogren**. The venue problem——

Senator **Biden**. It has been stated by Mr. Trott at the outside one of the reasons it was settled was because of the venue problem.

Mr. **Trott**. No. Then I did not make myself clear. The venue problem relates to the restitution angle. That is all.

Senator **Biden**. I understand that. But it related in turn to why you settled, because you wanted to protect people, you wanted to get restitution.

Mr. **Trott**. Now, that timing element was the key part.

Senator **Biden**. That is right. I understand that.

Mr. **Trott**. All right.

Senator **Biden**. But would you answer the question. Would it have solved the venue problem? Could you have brought——

Mr. **Ogren**. No.

Senator **Biden**. Why?

Mr. **Ogren**. Because the restitution turned on mail fraud and——

Senator **Biden**. I am not saying the restitution. The venue. Could you have brought all the actions in one location?

Mr. **Ogren**. No.

Senator **Biden**. You could not have?

Mr. OGREN. No; we could not have brought the mail fraud provision actions that required venue elsewhere. We could not have.

Senator BIDEN. You could not under RICO?

Mr. OGREN. Under RICO you can bring tbe RICO charge which is one count.

Senator BIDEN. Now, is that not enough to bring in the other offenses you were pursuing?

Mr. OGREN. Senator, you are now talking about the admissibility of evidence as opposed to convictability and the propriety of charges.

Senator BIDEN. You are right. That is all I am talking about.

Mr. OGREN. Right.

Senator BIDEN. So why do we just not answer the question?

Mr. OGREN. So the answer is no.

Senator BIDEN. I just want to make a record here. I want to make a record refined. You say no. Correct?

Mr. OGREN. Right.

Senator BIDEN. Good. We have got it.

Now, let me move on if I may.

If you had otherwise thought you could proceed under RICO—which you conclude you could not have because there was not, in your view, a pattern—could you have secured a mandatory criminal forfeiture of the proceeds of the illegal scam, assuming you could calculate the scam?

Mr. MURRAY. You could not calculate the full amount.

Senator BIDEN. I said if you could calculate.

Mr. MURRAY. Assuming—I am sorry.

Senator BIDEN. Could you have?

Mr. MURRAY. I am trying. I do not.

Senator BIDEN. Look. I am going to say it one more time. OK? And then we will let the chairman decide what to do.

Let us just pretend for just a moment——

Mr. MURRAY. I think I understand your question. If we had gotten a conviction, could we have in fact received restitution or forfeiture of assets under the RICO statute. The answer is yes. If we——

Senator BIDEN. Fine. Fine.

Mr. MURRAY. If we could have gotten the conviction—let me explain, please.

Senator BIDEN. You have made it clear why you do not think you could get a conviction.

Mr. MURRAY. Because we could only get a conviction by revoking the plea agreement and the company admitting to the charges. Because what happened——

Senator BIDEN. That is right. I understand your case. I understand that the bottom line is you do not think you could have convicted them of anything——

Mr. MURRAY. No, I am not saying that. May I just say that I would have prosecuted this case until the day I died. If this plea agreement had not been exactly dictated the way we wanted it and the way it was to protect this country, I would have prosecuted this case for 5 years or 10 years or whatever. Now, if you do not believe that, you ask E.F. Hutton's attorneys.

Senator BIDEN. You guys sound like you are from the State Department. I do not understand why you will not answer the question. It is clear. You have made your case. You say, look, we got the best deal for America. We saved a great deal. It is the greatest white collar crime. I understand what you concluded. I am not questioning your honesty. I am not questioning whether or not you believe what you are saying. That is not the issue for me here. That is not the issue.

Mr. MURRAY. Are you not questioning our judgment?

Senator BIDEN. I am questioning your legal judgment, yes.

Mr. MURRAY. And that is what we are trying to answer fully, I thought. I mean, I thought that is why I testified in front of the House subcommittee. And you are questioning our rationale in doing what we did.

Senator BIDEN. That is correct.

Now, I accept for the purposes of these questions your assertion that you should not have proceeded under the conversion statute, that you should not have proceeded under RICO. I accept that that was your judgment. Now we are beyond that.

I am asking you to answer the question. If you were wrong in your judgment and you had proceeded, what would have been the legal effect if you could prove what you conclude you cannot prove? That is what the questions are. That is all.

I understand your point. As a matter of fact, as one of my friends says, I overstand it.

Mr. MURRAY. If we had proceeded and gotten convictions on all criminal charges, no matter what vehicle——

Senator BIDEN. That is all the question is.

Mr. MURRAY [continuing]. We would have utilized, we would have been able to receive restitution upon the counts on which the individual defendants or corporate defendants would have been convicted of. We would not have been able to use or dictate the terms of the civil injunction regarding the various money management practices that in fact we did.

Senator BIDEN. Under civil RICO would you have been able to get an injunction had you prevailed?

Mr. OGREN. We had an easier route——

Senator BIDEN. I did not say that. Answer the question. Would you have——

Mr. OGREN. I said yes, but we had an easier route.

Senator BIDEN. Now, do you want to amplify on it?

Mr. OGREN. I would like, if I might, Senator, because I think that the question you posed the last time was answered by Mr. Murray, but I think it is important——

Senator BIDEN. Well, we have double-answered everything, but go ahead.

Mr OGREN. Well, we all have different opinions, Senator, and one of the reasons why is, notwithstanding what appears to be in a sense, with all due respect, an effort to try to pare this case down simply, it is not a simple case.

Senator BIDEN. There is nothing simple about this case.

Mr. OGREN. The issue on forfeiture, which was the issue you raised before, raises a very tricky RICO point, and I do not know the answer to it. Maybe your counsel knows the answer to this one.

Senator Biden. He wrote it. I think he does.

Mr. Ogren. Well, he may not because this is one that I find interesting, and that is whether or not an enterprise interest in itself is forfeitable; that is, whether or not the defendant can be the enterprise also. In this instance, what you have is Hutton being the enterprise. It is an unusual situation. There have been cases that have been brought in which the forfeiture of the interest of the enterprise—that is, its own ownership in itself, its own assets—has been upheld, but it is an interesting question. So I am not sure what the answer to that is in this context. We may not have been successful.

Senator Biden. Had you been successful, what would the victims be entitled to under a private civil RICO theory of recovery, had you been successful?

Mr. Trott. Under a private civil RICO theory of recovery?

Senator Biden. Yes.

Mr. Trott. We will have to answer that for the record. I am not sure.

Senator Biden. Three times your established damage plus counsel fees; correct?

Mr. Ogren. If the private litigants recover it, that is correct.

Senator Biden. Yes; under the restitution program you negotiated, did the victims, in order to participate in the restitution, have to waive all other claims of relief?

Mr. Trott. No.

Senator Biden. OK. Fine. Explain that to me, please.

STATEMENT OF PETER B. CLARK

Mr. Clark. The banks had an option. The victims had an option. They could participate in the restitution program that we devised, or they were free to negotiate or bring a suit, including a civil RICO suit, if they chose to do so.

Senator Biden. I think you are anticipating what I am saying rather than listening. Let me read it again.

Under the restitution program you negotiated, did the victims have to waive all other claims for relief if they chose to participate?

Mr. Clark. If they chose to participate in that restitution program?

Senator Biden. Yes.

Mr. Clark. Yes, they did waive it.

Senator Biden. That was my question.

Mr. Clark. But they were not obligated to participate.

Senator Biden. I understand that. We will get to it. Take your time.

Now, will you explain to me whether or not, and you can give me an estimate like Mr. Trott forthrightly did earlier, about the prospects of success proceeding under the theory that you had—and I thought it was, quite frankly, a fairly ingenious theory you came up with under the fraud statute. Notwithstanding that, you assessed that had you proceeded under that theory it would have been problematic.

Mr. Trott. A substantial litigation risk.

Senator **Biden**. Substantial litigation risk. Now, how would you characterize litigation risks had you attempted to proceed under RICO? Now, I know you say you cannot answer that. Maybe I will ask that of the man who spent the most time considering whether RICO was applicable.

What would you assess the litigation risks had you attempted to proceed under RICO?

Mr. **Murray**. The same, Senator, because it would go back to proving the intent to defraud based upon the float issue.

Senator **Biden**. That is my question. It would have rested on the predicate issue, correct?

Mr. **Murray**. Yes.

Senator **Biden**. OK.

Mr. **Ogren**. I believe that is correct.

Senator **Biden**. Now, with regard to negotiating with what you consider to be a serious or however you want to characterize it—I will characterize it the way it was characterized in the statement—what amounted to deceiving banks into giving interest-free, unsecured, short-term loans, Hutton was required to plead guilty.

Now, you went in with the belief that E.F. Hutton in fact had put itself in position where at a minimum it overreached in a criminal nature so that it was receiving interest-free, unsecured, short-term loans. Correct? That was your belief. Notwithstanding what you could prove, that was your belief. If you did not believe that, you would not have proceeded, would you? Or would you?

Mr. **Murray**. Are you asking me, Senator?

Senator **Biden**. Yes.

Mr. **Trott**. We did believe that Hutton was guilty of offenses. That is absolutely correct.

Senator **Biden**. All right. So now you have explained to me straightforwardly that you thought the litigation risks were significant.

Mr. **Trott**. That is right.

Senator **Biden**. And they were significant, the significance of which did not differ much whether you proceeded under the mail fraud or wire fraud or mail fraud and wire fraud, the predicate offense to RICO, whether you added RICO on.

Now, do you believe you would have been in a stronger bargaining position for purposes of negotiating for the welfare of the banking system, for the welfare of America, for the welfare of the victims—all the things you say was the reason why you negotiated. Do you believe you would have been in any stronger position had when you said to E.F. Hutton's attorneys, we are prepared to work out a plea here, let us talk, would you have been in a stronger position in your view had you also indicated to them you were going to proceed under RICO both criminal and civil?

Mr. **Murray**. No, because that had already been done. I did that in relationship to Tom Curnin back in April 1984. I have threatened Tom Curnin and the company with decapitation, and that did not bring them to the bargaining table in April 1984.

Senator **Biden**. What finally brought them to the bargaining table?

Mr. **Murray**. The fact of the matter that they were going to be charged with a felony, and if in fact they were charged with a felony, it might mean the revocation of their license.

Senator **Biden**. Now, would not the charging of a felony and the application of RICO have made your case stronger?

Mr. **Murray**. Not really. It would have had the same effect. Hutton was afraid of being charged with a felony because they were afraid of losing their license. That is what they were afraid of. What they wanted was a civil disposition, and we took the attitude that there was no way that was going to happen, and that in the event they did not want this plea agreement, we were going to trial within a week.

Senator **Biden**. Fair response. Let me ask you one last question, and I appreciate my colleagues' patience here.

In the *Watergate* case, the Department followed an investigative strategy of indicting lower level people in seeking after conviction to obtain their testimony for people who were further up the ladder. It was a deliberate strategy.

Was that strategy considered here? And if so, why was it rejected?

Mr. **Murray**. Yes, sir. That strategy was used from day one. Our strategy was that what we were going to do is that we were going to start at the lower levels, at the branch office managers and the cashiers, anybody that touched the drawn-out system, that we were prepared to grant them immunity to establish the office procedures in efforts of trying to in fact get criminal information against the higher-ups.

Senator **Biden**. That is not what was done in Watergate.

Mr. **Murray**. OK.

Senator **Biden**. In Watergate they got a conviction.

Mr. **Murray**. Well, I do not know about it. We could not have taken a mass of 7 million documents, 500,000 exhibit case, and prosecute a branch cashier who makes $12,000 a year, who does not know anything from anything, to try to flip them over.

Senator **Biden**. Your contention is, then, that there was no one above a branch cashier who you think you could have made a case on.

Mr. **Murray**. No, I did not say that.

Senator **Biden**. Well, let me ask you this. That was the implication, I thought. I apologize.

How far up the chain of authority do you think you could have made a case?

Mr. **Trott**. Senator Biden, may I just intercede for 1 second?

Senator **Biden**. Sure.

Mr. **Trott**. I believe the way we have described that is that we believe that we could prosecute people in the money management chain of Hutton. That is dangerously close to a violation of rule 6(e), and with all due respect, I think to identify individuals or positions might violate our responsibility to not identify people who have been investigated by a grand jury and not prosecuted.

Senator **Biden**. Was it someone in the money management cash system that in fact had a significant position within that division?

Mr. **Murray**. Yes; and may I finish? My strategy always from the beginning is to start at the bottom of a tree, as in any investigation, I know you are well aware, start at the bottom of the tree and you start from the bottom and you work your way up to the top of the pyramid. That is the way you investigate.

Our particular strategy was that we prepared to give branch office managers and cashiers immunity in the event that they exercise their fifth amendment privilege against incrimination. Because it was our theory that a jury would never convict a little Al Murray or somebody at the bottom level, but what we had to do is wrap an indictment around the neck of the president or the chairman of the board. Because without that, what would happen, the jury may well believe that this is scapegoating. And so as many times as we would throw tar on the chairman of the board as he testified at the trial, he would walk away free. And what the jury would say is that these lower level people are scapegoats.

Senator BIDEN. That is assuming that Watergate strategy is not applicable. The whole essence of the Watergate strategy. I just want to make sure I understand. The Watergate strategy was that little fellow, as he is about to go down, finds himself saying, "I am not going alone. I am going to go to the next person up I know I can make a case on." That is the Watergate strategy.

Mr. MURRAY. In 1982 I prosecuted 30 political vote fraud cases in Luzerne County. Our office, the Middle District of Pennsylvania, prosecuted the largest amount of political figures, elected political figures in the country for that year. The way we did that over 3 years is we flipped the little guy at the bottom. He pled guilty, flipped over, testified against the big guy. Ultimately we prosecuted the mayor and the head of the Democratic Party of Luzerne County. That is what we did.

I used that same strategy with this case. The difference was——

Senator BIDEN. Well, why did you give immunity before you got testimony?

Mr. MURRAY. No, that is not true. What we did specifically is we prepared for the testimony by preparing the documents and the charts relating to that individual. We could not get a conviction of a branch cashier to flip over. We had to prove it from the bottom.

Senator BIDEN. Why did you immunize Bacon before you got testimony?

Mr. MURRAY. We did not do that. We had proffers from Bacon. We knew what the activity was——

Senator BIDEN. Would you submit that for the record?

Mr. MURRAY. What we did is we had the charts done regarding United Virginia Bank, I believe. We knew exactly what his activity was, and what we were hoping is that Perry Bacon had a direct conversation with George Ball or Bob Fomon concerning activity. What we did, we had a proffer.

Senator BIDEN. Would you be prepared to submit for the record under any circumstances you wish that testimony of Mr. Bacon prior to you having given him immunity? That is my question.

Mr. MURRAY. We did not have any written testimony. We knew——

Senator BIDEN. Did you have any oral testimony from him?

Mr. MURRAY. I believe we had a proffer from Peter Driscole, I believe, who was his attorney.

Senator BIDEN. It must be written down somewhere, right?

Mr. **Murray**. No.

Senator **Biden**. In your records? You did not keep a record of that?

Mr. **Murray**. No; the way we do things is that we may get an oral proffer that we do not keep a record of, and then what happens, when we formalize that in the immunity agreement, we put all that in writing. That is the policy of our office. And it is the policy, I believe, of the Postal Inspection Service to do a memorandum of interview if they are involved in the case.

Senator **Biden**. A memorandum of interview?

Mr. **Murray**. A memorandum of interview. The FBI, they do 302's. And that is how that is handled.

Senator **Biden**. OK.

Mr. **Ogren**. Senator, may I just add one thing?

Senator **Biden**. Sure.

Mr. **Ogren**. On the issue of the going up the chain, your observation about the Watergate strategy is a well-taken one and very often is a——

Senator **Biden**. It may not be applicable here.

Mr. **Ogren**. No, it is an excellent idea. Mr. Murray faced an unusual problem, as I understood it, hearing about how the investigation developed, not the least of which was assuming that the case was to be put together in our collective lifetimes that we are now sitting in 1986 and the last of these events occurred in 1981 and the statute of limitations would run. So there is only a limited period within which——

Senator **Biden**. I am sorry. Say that again?

Mr. **Ogren**. These events occurred ending in 1981, the ones that were charged criminally. So with a 5-year statute of limitations, you begin to run out of time with respect to the offenses that occurred, and if you take a lot of time going after lower levels, you may never get around to the real objective, which is what Mr. Murray was after, which was the corporate entity, the higher officials. And you have to be careful when you adopt that strategy that you do not put your feet in concrete. And I think his position was to get beyond the impediments that a series of low level prosecutions might create for him.

Senator **Biden**. What is the statute of limitations on civil RICO?

Mr. **Ogren**. Off the top of my head, I do not have it. I thought we were talking criminally.

Senator **Biden**. No. I am talking about all avenues that you could follow.

Mr. **Ogren**. We are talking criminally a 5-year statute of limitations, and that is what we are dealing with.

Senator **Biden**. Well, you also had an option to deal civilly.

Mr. **Ogren**. We did.

Mr. **Trott**. Civilly?

Senator **Biden**. Civil RICO, you had that option. You could have potentially, theoretically, gained the same result you said you wanted—stopping of the practice, restitution.

Mr. **Murray**. I think that is right.

Senator **Biden**. That is what you got, right? You got a fine, no imprisonment——

Mr. TROTT. Senator, I believe that if we had resolved this case on a civil basis that we would not be facing just very sharp and very educated questions, but flamethrowers.

Senator BIDEN. Well, you may be right. That may very well be.

Mr. TROTT. It never crossed my mind to resolve this on a civil basis, and if anybody would have come to me with a civil settlement, I would have thrown them out of my office.

Senator BIDEN. You may be right. You may be right. I just asked the question. The point was the statute of limitations would have prohibited you being able to accomplish what you did. The only point I am making is you may for political reasons conclude you could not do that—positive political reasons, not negative—but in fact you could have under the civil RICO statute theoretically arrived at the same spot.

Mr. OGREN. Senator, after 5 years, if we do not have a criminal basis, we cannot use the grand jury and we cannot—I mean, I do not think that is realistic.

Mr. TROTT. Not for political reasons either, but because a civil settlement to the case, in my judgment, would have been inappropriate. And if that would have been the option, we would have tried this case for as long as it took. In fact, we combined civil and criminal.

Senator BIDEN. That was my point; I was going to make it. I will come back another time and another day.

Senator METZENBAUM. I have sat here for over 2 hours and I am not complaining because I want to be educated. I heard Mr. Murray say that they wanted to hold up or maybe, it was you, Mr. Trott, who said that you wanted to hold up E.F. Hutton as an example of a corporation in this matter. You thought that it was a good example to show the country.

Now, the thing that is still bothering me, the last 2 hours and 10 minutes, why you did not prosecute any individuals? Let me get into that but just stay with me

First of all, as I understand, you granted 57 people immunity?

Mr. TROTT. They really amounted to nonprosecution agreements is, I guess, the best way to describe it. We did not use statutory immunity. It was nonprosecution agreements in return for testimony.

Senator METZENBAUM. And what kind of people were they? What level of people?

Mr. TROTT. Al can tell you in detail.

Mr. MURRAY. Senator, they were branch office managers, cashiers, and there was, I believe, one mid-level official and one other person. None of the, what I might call, putative defendants, or possible defendants were granted immunity.

Senator METZENBAUM. Under what circumstances was it necessary that you grant them immunity?

Mr. MURRAY. Yes, it was.

Senator METZENBAUM. Why?

Mr. MURRAY. Because they were attorneys and they were all represented by counsel and they exercised their fifth amendment privilege against self-incrimination. They would not have testified, they would not have given us the evidence regarding the actual transactions occurring. There was no alternative. There was either granting them letter immunity or not having their testimony.

Senator **Metzenbaum**. Did they all have the same attorney?

Mr. **Murray**. No, they did not.

Mr. **Trott**. Senator, if I could add one thing to this? People seem to forget that for a long time, Mr. Murray and the Postal Inspectors were involved in an investigation trying to find out what in the world happened, and how it happened? And it took tremendous work in the development of this case through testimony to prove all the things that we now know. And so what you are faced with when you get into a case is an array of people who know something, all of whom have the ability to assert the fifth amendment and they did in this case.

You have two choices at that point. You can walk away and try to come at it from another direction and that was discussed, or you can say, OK, this is the type of person that we would not end up prosecuting in this case, this is not the type of person who is a target. So, in order to go for the ultimate objective, you give a nonprosecution agreement to that person and you move toward the ultimate objective.

Senator **Metzenbaum**. And were their attorneys retained for them by E.F. Hutton?

Mr. **Murray**. I do not know. I believe that they were. The attorneys indicated to me that they will always represent the individual, etc., etc., but I think what happened is that Hutton counsel sent those individuals to these various attorneys.

So, be that as it may, and be that as it may we threatened or claimed that there was a conflict of interest or whatever, we had to deal with the attorneys as they were.

And, also many of the people, such as branch office cashiers, had no criminal intent. Although, and let me—the problem with why they took the fifth, Senator, was this—it was my theory back then that any person who touched the draw down system, who wrote a check, say for $9 million when that cashier knew and saw on its books that day that they only took in $400 had potential liability and exposure. And because I took that wide ranging theory, the attorneys came in and indicated, therefore, my client may have criminal liability and therefore they took the fifth.

But we needed their live testimony to bring those figures alive, if you know what I mean?

Mr. **Trott**. As a supervisor, I do not think that for 1 second that there was an excessive use of grants of nonprosecution agreements in this case.

Mr. **Murray**. There were 57, Senator, out of 2,500 people that we could have granted immunity to.

Mr. **Trott**. And they were not targets at that time.

Mr. **Murray**. And those people were not targets.

Senator **Metzenbaum**. Who made the arrangements for the plea bargain?

Did you propose it, or did Hutton propose it?

Mr. **Murray**. Well, I guess there was a history. When the Department of Justice was not involved, our office negotiated, especially David Queen, negotiated with Cahill Gordon, Hutton's attorneys for over 2 years. We, our office, rejected any settlement with them on a civil basis—that is what they wanted, or no prosecution whatsoever. And we just rejected that.

Senator **Metzenbaum**. They wanted what?

Mr. **Murray**. Hutton's position was always that they wanted a civil resolution to the case. They believed this was a knowing business relationship between them and their banks and that we were not involved in it. It was not meant to be for criminal and basically we should just keep our noses out of it. In other words, the Department of Justice.

That was not our position. And what they wanted, Senator, was a civil resolution. They thought that it ought to go to the SEC at worst, or that it ought to be an injunction or whatever.

It was our opinion, our office's opinion, that it was criminal and that is why we never ended up getting a plea bargain at that time.

Then what happened, there was a—Senator Biden talked about the Perry Bacon memo. That is what I call——

Senator **Metzenbaum**. What is that?

Mr. **Murray**. There was a Bacon/Braylove memo. That was a smoking gun as far as I was concerned, that showed that this was a criminal action. And as a result of that, right after that memo surfaced, E.F. Hutton came forward and offered to sit down and talk with us. That was in March 1985.

So they came to us.

Senator **Metzenbaum**. Did you give Bacon immunity?

Mr. **Murray**. Yes; I did.

Senator **Metzenbaum**. He was not a low-level, just cashier. He was not a low-level person. He was important enough that in order to get rid of him they gave him $600,000 in separation and bonus compensation.

Mr. **Murray**. Perry Bacon was a branch office manager. He was, as well as there were 400 other branch office managers throughout the country. He happened to be one of the persons who made a lot of money but he did not have a lot of authority as far as the money management practices. The money management practices of the company were set forth by Tom Orley and Tom Lynch. Bacon, basically, was a branch office manager. The majority of his income came from the sales of securities. It had nothing to do with his managing the operations of the general ledger sheet which produced the income.

Senator **Metzenbaum**. How about Mr. Ball?

He knew about it. Why did you not prosecute him?

Mr. **Murray**. Well, he did not appreciate the nature of the conduct that was occurring in these accounts.

Senator **Metzenbaum**. Do you know that he did not appreciate the nature of the conduct? How do you know that?

Mr. **Murray**. Well, based upon the evidence that I gathered. I do not know what was in Mr. Ball's mind. What I tried to do was to prove circumstantially what was in his mind and I also tried to prove through direct evidence, and facts and documents, what was in his mind. But basically, when we added all the evidence up, I believe that it was insufficient.

Senator **Metzenbaum**. Well, I have difficulty and I do not want to say this, but this man who sits——

Mr. **Murray**. He was negligent.

Senator **Metzenbaum** [continuing]. Sits in the audience, and was president of the company until July 1982. He knew that this was taking place. There is evidence that there was a memo in his hand that Hutton offices generated $5.4 million by overdrawing bank accounts. I do not know how many other memos there were, but there was at least one.

Mr. MURRAY. There were several.

Senator METZENBAUM. Several, all right. And we know that he was sent two memos, in February and March 1982, discussing how the profits should be credited to the branches of E.F. Hutton.

The first memo asked Ball to determine whether the branches, themselves, or the Hutton regional offices should be credited with generating the profits. The second memo, dated March 17, 1982, detailed the method by which the branches would be credited with the profits Hutton earned by overdrawing their accounts and thereby getting interest-free use of bank money.

Mr. MURRAY. Senator, that does not mean anything. What I tried to explain in the beginning, was that overdrafting—a ledger overdraft or a book overdraft is not, itself, criminal.

Mr. TROTT. There are $100 million of daylight overdrafts every day in this country, none of which is criminal.

Senator METZENBAUM. I understand; but the fact is this memo indicated that they knew they were making a profit.

Mr. MURRAY. Everybody knew that.

Senator METZENBAUM. They knew that they were deliberately doing it.

Mr. MURRAY. Right.

Senator METZENBAUM. You thought that it was bad enough that you said that the E.F. Hutton Co. devised and intended to devise. A person, not a corporation devises a scheme and artifice to defraud and obtain money from various banks and financial institutions.

You said that the object of the scheme, of the defendant's scheme and artifice, was to defraud to obtain interest-free funds by a means of intentional overdrafting of various of its depository bank accounts.

You said that it was part of said scheme and artifice to defraud, that the defendant, Hutton Co., would fraudulently misuse its depository bank accounts for the purpose of obtaining the interest-free use of bank funds by the following activities including, manipulating the check collection system and procedures of the Federal Reserve System in causing repeated and substantial drawings against uncollected funds, (*A*), drawing down arbitrary amounts, unrelated to and in excess of the volume of customer funds deposited; (*B*), causing funds to be successfully transferred between various branch and regional depository bank accounts of the defendant, prior to their deposit in a prime depository bank, thereby inflating the funds drawn down so that they exceeded the amount of customer funds originally deposited.

You go on to say that it was a further part of said scheme and artifice to defraud that the following manner and means were utilized to further the fraudulent misuse of the defendant Hutton Co.'s depository bank accounts. You go on to say, covering the checks described in subparagraph (A) above by drafting checks upon zero balance accounts and depositing said checks into the defendant Hutton Co.'s branch and regional depository banks for the purpose of conceding the arbitrary and excessive amounts of overdrafts of said depository accounts.

Now, you have said all of that in your complaint which was verified. Mr. Ball knew what was going on. He was told in a memo how he should allocate the funds and what I do not understand from all of you, why did you not prosecute somebody individually?

This stuff about not being able to handle it all over the country, that is hokum.

Mr. TROTT. Senator, first of all, I will make this statement for the third time, probably, today. I apologize for repeating myself. We, and I am flirting with 6(e) here, we believed that we identified the intellectual authors at the highest levels of this scam. We could have prosecuted them. We chose not to.

Senator METZENBAUM. That, I know.

Mr. TROTT. And we explained why.

Senator METZENBAUM. That is a given.

Mr. TROTT. All right, and we did not find that the evidence, and this is the collective judgment of the investigative team and the investigators, we did not find that type of evidence against Mr. Ball, Mr. Fomon, or the other kinds of people that we keep getting asked about. And so, therefore, we did not prosecute them. We will never prosecute anybody if the judgment of the prosecutors and in the Department of Justice is that the evidence does not establish guilt, and we did not have that quantity of evidence against people at the higher levels.

Now, Mr. Murray will tell you that he originally believed that—just as do you still—that this must have emanated from those levels.

Senator METZENBAUM. Of course, it emanated from there.

Mr. TROTT. But we cannot indict on the basis of must have, could not have happened unless, or anything else. We have to have hard evidence. After 3 years, 7 million documents, 300 subpoenas, it was our judgment that we did not have it. And if we had had it, I will tell you this right now, if we had had evidence that it had gone to those higher levels, the settlement that we are talking about today would have never occurred.

Senator METZENBAUM. If you believed it, why did you not——

Mr. MURRAY. Senator, what you are talking about in relationship to George Ball, which you just read, we had that evidence in 1982. We turned it over. That is why the intracacies of float is so important. The reason why, because what you are talking about right, is Hutton's white vanilla drawdown sheet.

Senator METZENBAUM. That is right.

Mr. MURRAY. 17,000, 2,500 employees in that corporation were working every single day with the drawdown sheet which I tried to explain concentrated money to New York. When you do that, you are playing with the float. They are talking about making money off the float. That is not talking about specific criminal conduct relating to unlawful overdrafts. It is talking about a system designed to recapture float. Now, Mr. Ball has to appreciate several things for us to hold him responsible criminally based upon what that says. We have to prove that his attorney, we have to prove that he knew that in fact, what was going on, is that float intentionally being created by certain persons in excess of the float over and above in that account. We had to prove that he, specifically, knew——

Senator **Metzenbaum**. What about the comptroller general? I do not know if he is comptroller general. Michael Castillano?

Mr. **Murray**. He is the controller of the company.

He is the controller of Hutton.

Senator **Metzenbaum**. All right, he said in a memo to George Ball,

> Although you have made the decision to give branches credit for interest earned via overdrafting regional bank accounts, how these branch interest credits are determined and accounted for is still unresolved.

He went on to say, on interest profit allocation,

> Recommend calculating each branch's relative percent of total general ledger interest for all branches in the region. The largest segment being bank account overdrafts.

Mr. **Murray**. Right. May I explain to you what that means?

Senator **Metzenbaum**. I understand what it means. You do not have to explain to me what it means. I understand what it means.

Mr. **Murray**. I am sorry, I do not think that you do.

Senator **Metzenbaum**. What he is saying is that you have this money and first of all, you had better explain where it is coming from, and second of all, you had better decide how you are going to allocate it office to office.

Mr. **Murray**. Right, and——

Senator **Metzenbaum**. Just a moment. What I am saying——

Mr. **Murray**. Yes, sir: I am sorry.

Senator **Metzenbaum**. What I am saying is that he knew what he was doing and he was a party to it and you want to give me this argument, well, we do not have the convincing evidence. And what I am saying to you is, if it had been anybody of a lesser person, than somebody from E.F. Hutton, you would have thrown the book at them.

Mr. **Trott**. That is horsefeathers. And that is an accusation that we do not accept.

Senator **Metzenbaum**. That is what the American people think.

Mr. **Trott**. Senator, that is absolute horsefeathers.

Mr. **Murray**. That is a result of the press.

Senator **Metzenbaum**. The fact is that there is evidence that this man was involved and he knew what was going on and he was dividing the profits.

Mr. **Clark**. No, there is not, Senator.

The memorandum that you read, first of all, the language that you read from that memo refers to the term, "overdrafting."

There are at least three kinds of overdrafting that were involved here.

Senator **Metzenbaum**. Are any illegal?

Mr. **Clark**. Not the first one. Not the target balancing at that time. We believe that this is illegal or became illegal after 1344 was enacted. There is no way, and we tried our best to prove it, that the overdrafting that Mr. Ball and others referred to was the overdrafting that we believed that could be charged criminally.

Senator **Metzenbaum**. The overdrafting that I am talking about is the overdrafting that you charged in your own complaint.

Mr. **Clark**. That is correct, the arbitrary overdrafts.

Senator **Metzenbaum**. That is the same overdraft that the Wall Street Journal talks about.

Mr. **Murray**. That is not correct.

Mr. **Trott**. Wrong, Senator. That is the problem with this case; nobody understands this case.

Mr. **Murray**. Nobody understands bank overdrafts, ledger overdrafts, gross overdrafts, collected, uncollected positions.

Senator **Metzenbaum**. What is incorrect about it?

Mr. **Trott**. What is incorrect is that you were reading from our criminal information. Our criminal information is limited to two types of overdrafting—excessive overdrafting that occurred at a handful of locations, and the chaining. This document that you are reading from has nothing to do with that, Senator.

As a matter of fact, the date of those documents that you are reading from are dated several months after the scheme that we charged criminally was completed, and even, Senator, if it did relate to the drawdown system—as I told you before, overdrafting, at that time, was not inherently a crime. I have to repeat that, sir, it was the law.

Senator **Biden**. You have just defined—I think that it is important for everybody to know, we know but we have not been focusing on it—there are three kinds of overdrafts.

Mr. **Trott**. That is correct, Senator.

Senator **Biden**. At least one of which was only questionably illegal prior to 1344. The other two types of overdrafts—were there any questions in your mind that they were illegal—under 1341 and 1343 at the time that they were occurring, and define for the record, what the other two types of overdrafting were, please?

Mr. **Clark**. They were illegal and they are precisely the two that Senator Metzenbaum just read from the criminal information that we prepared and filed in this case. Now, the real question is, and Senator Metzenbaum, I think, may misunderstand, the real problem is in proving when a George Ball or a Fomon or anyone else writes in a memo the term "overdrafting" or uses the term "overdrafting" in a discussion or conversation, whether he is talking about, and whether we can prove that he is talking about, the kind of overdrafting that we believe can be charged criminally and not the kind that Mr. Murray calls the plain vanilla overdrafting.

Senator **Biden**. I understand that. How under the evidence that you had—what, in fact, was—what constituted an illegal overdraft that you would have difficulty proving on the facts that you had?

That is why I asked the question. You do not have to say the name, but I can. Mr. Morley, who was the guy who managed this, he knew all three kinds of overdrafts. There is no doubt about that from my reading—I do not know how many damn pages there—I never intended on getting as involved in this case as I had to. I wish that I never had. Because I have spent more time on this than arms control. But when you go through and read it, there is no question from your records I got from the Hughes Committee that Mr. Morley knew. My question is, Did you consider indicting and going after a conviction against Morley in the hope that Morley would explain what type of overdrafting Mr. Ball was referring to, because he, Morley, would know in all probability.

Mr. **Trott**. Senator, I am very uncomfortable discussing this because—and this is not a speech, but I think that you share this philosophy—part of the tradition of this country is that when somebody is investigated and not indicted, that there is secrecy that attaches to that so as not to trash a person's reputation.

Now, with that in mind, I am going to answer your question in the abstract. The people that I have continued to say that we have identified as the intellectual authors, did we consider indicting them and flipping them or whatever you want to say?

And the answer is, "Yes." We did not because in our judgment it would not have gotten us where we intended to go from the outset. So we did not do it.

Senator **Biden**. Why would it not have gotten you that?

Mr. **Trott**. Because the investigation, in my judgment, based on what I had seen, had been so thorough as to comb those upper levels already. We knew what we were dealing with and that was not necessary.

Senator **Biden**. You are saying that his instinct was wrong. His instinct was—your prosecutor—that somebody up above did know.

Mr. **Trott**. No; I am not saying that it was wrong at all. I am saying that it was an accurate instinct, it was my instinct, it was everybody's instinct.

Senator **Biden**. OK, well, then, obviously you combed it as far as you could. Look, I am sitting here and I am a prosecutor. And I say to myself, I know John done it. I know that. I just cannot get the hook. I know Charlie did it, and I do have a hook. Therefore, the only way that I get the hook on John, who is Charlie's boss, is not a selective indictment. I have the facts on him to the best, at least I have a better than even chance of getting a conviction.

I proceed against Charlie because Charlie knows what I only suspect. If my suspicions are wrong, then he does not flip. If my suspicion is right, he flips and he says, what you were looking for to confirm your suspicion is the following—here it is—my testimony.

Mr. **Murray**. Senator, based upon the evidence that we had available to us; based upon things that I knew, that Mr. Morley knew, and that Mr. Ball knew, I was convinced that even if we had flipped Mr. Morley, and then we would have been criticized for giving the cash manager immunity, the person who was the hub of this scheme, he would not have been able to provide the——

Senator **Biden**. No; I am talking about indicting them.

Mr. **Murray**. No. I am talking about either granting him immunity or acquiring his testimony to try to get Mr. Ball——

Senator **Biden**. That is not what moves people. You indict them.

Mr. **Murray**. No; I am saying——

Senator **Biden**. That moves them.

Mr. **Murray**. I am saying, I know what it is to be a hard prosecutor, put my foot on somebody's neck. OK, I do understand that. That is what I did with E.F. Hutton for 3 years. But what I am saying, even if we had done that I know that that evidence would not have produced the type of criminal intent to be placed in the mind of George Ball, that would have been necessary for us to do it.

Senator BIDEN. You think that Morley either did not have that information or would not have yielded that? I mean the intellectual authors.

Mr. MURRAY. I am convinced that based upon the evidence that was before us, that it would not have produced the mens rea necessary to indict a George Ball, and, in fact, if we could have, I would have.

Senator BIDEN. The only way you could provide the mens rea, in light of the evidence that you had available, was if Mr. Morley provided it for you.

Mr. MURRAY. No. It could have been many people that could have provided it for us.

Senator BIDEN. I am sorry, you are absolutely correct.

I stand corrected. Mr. Morley is not the relevant question. There could have been—the only way that you could have provided the mens rea—and by the way, I do not know Mr. Ball from Shamokin. You know where Shamokin is.

Mr. MURRAY. I do know where Shamokin is.

Senator BIDEN. I do not know Mr. Ball from Shamokin.

Mr. MURRAY. There are not many people in Shamokin.

Senator BIDEN. So I am not suggesting this is designed for Mr. Ball. We are just talking about anybody further up in the organization. The only way you would, in light of the deadend that you came up against after such a thorough investigation, would be to provide the intent element for folks who think what we are talking about here, would be if you got someone else.

Mr. MURRAY. Right. Live testimony.

Senator BIDEN. That is right. And it is your judgment that you could not have gotten that live testimony from indicting people—not making up indictments, but people who deserved to be indicted, otherwise, if all things were equal.

The reason that you did not indict them is because you concluded that the better way to go was over here. We are only talking now about, and I am still confused as to what your rationale was—not your rationale, what your judgment was.

We acknowledged that you had somewhat, you start off and you say, A, our objective always, first and foremost, is to indict and convict individuals and not corporations.

Mr. MURRAY. Both.

Senator BIDEN. Yes; but is either one of a higher priority?

Mr. TROTT. No; we try to get the whole package.

Senator BIDEN. So that they are equal.

Mr. TROTT. I do not see it in terms of being equal; it is a package deal.

Senator BIDEN. But you said that it is always the case.

Mr. TROTT. Our general approach is to get both as a package.

Senator BIDEN. Yes, obviously, I would like to get it all.

Now, you cannot get both, which do you go for?

Mr. TROTT. We do the best that we can with what we have.

Senator BIDEN. Right, OK, fine

Mr. TROTT. And it is going to vary depending on proof.

We have investigated some cases recently where we go like hell forever and we do not get to the individual culpability.

We got the company cold.

Senator **Biden**. But I thought that you said at the beginning of your testimony and I thought that it was policy of the Justice Department——

Mr. **Trott**. To get both.

Senator **Biden**. Not only to get both, but that, in fact, it was to pursue individuals.

Mr. **Trott**. Absolutely.

Senator **Biden**. OK, fine, that is all.

Now, you have this policy to pursue individuals. And what I am concerned about is, that I think from all that I have read, and that what you have said here, that you at least had sufficient evidence to indict middle management person, or persons, based on reading the documents, had relationships with people, professional relationships with the company, who exceeded their level of authority.

Mr. **Trott**. We have said that from the very day that this case was announced.

Senator **Biden**. I know. You concluded, not to do that, because—and here is where I am confused, is it because you believed that they did not possess the ability to provide for you even if they wanted to, the intent element or is it because you believe that they were just tough, hardnosed, G. Gordon Liddy's, who would not be flipped?

I mean, why did you not indict and see?

Do you understand what I am saying?

Mr. **Murray**. Yes, I sort of understand what you are saying.

Senator **Biden**. I am just looking for your judgment, that is all. You all sat there and discussed it.

Mr. **Murray**. What I tried to do was that I tried to build a case to the top of the pyramid, in the best manner in which we could do it.

Senator **Biden**. And as far in the pyramid that you got is midlevel?

Mr. **Murray**. I would have flipped anybody that I could have without giving up the benefits of the case, in order to wrap an indictment around the neck of Mr. Fomon or Mr. Ball, or whomever else was responsible.

I thought in my——

Senator **Biden**. I do not know whether Mr. Fomon or Mr. Ball——

Mr. **Murray**. Well, he is the head of the company and that is what America wants to see, that the rich man not get off, but the person who is the head. I determined in my discretion and if I was wrong, then I am subject to criticism, but I know that I was not.

That, the persons that we turned over, could not give evidence that was sufficient enough to put criminal intent in the mind of so and so.

Mr. **Trott**. I did not think that we were dealing with hard-heads who were holding out if that is your question.

Senator **Biden**. That is my point. You just think that they would not have, even if they wanted to flip, and they would not take you up any higher.

Mr. **Trott**. See because we tried. Al had been all over this case. He had not just been working at the lower levels when we came to the final conclusion and the grand jury had been all over the case, top and bottom and all around.

Senator BIDEN. I know that. You got all over the case, and you walked out of the grand jury and you said, I know someone up there did it, I just cannot prove it.

Mr. TROTT. No, no, no, that is not true at all.

Senator BIDEN. Oh, you did not?

Mr. TROTT. No.

Mr. MURRAY. We came out of the grand jury thinking that it was the collected intent of the entire system that everyone, all 2,500 people that touched the drawdown system that the system was operating collectively as a bad fraudulent system.

Senator METZENBAUM. But the buck stops with the president of the company. And you had indicated to me, sir, that this was the wrong time. What is your name, sir, I am sorry?

Mr. OGREN. Robert Ogren.

Senator METZENBAUM. You had said to me it was not the right time. You had said to me there were different kinds of overdrafts. Let me read you a series of memos that George Ball, president, saw and commented on.

Mr. TROTT. Excuse me, Senator, Mr. Chairman——

Senator METZENBAUM. We do not have a chairman. You can address anybody.

Senator BIDEN. What is the question?

Why do we not take a 5-minute recess? We will recess for 5-minutes.

[Whereupon, a 5-minute recess was taken.]

Senator BIDEN. Senator Metzenbaum.

Senator METZENBAUM. Mr. Trott and Mr. Murray, the reason that you did not prosecute the individuals is because you apparently did not feel that you had the evidence. And yet, the more I examine into this case, the more confirmation I find that it was a definitely designed and devised plan to earn money in this manner.

Mr. TROTT. That is exactly what we charged and we agree with you 100 percent.

Senator METZENBAUM. And the only place where we disagree is why you did not go after some of the higher-ups.

Mr. TROTT. We did go after them with a full investigation and a grand jury that took 3 years and collected 7 million documents, hundreds of witnesses, and analysis of all of the evidence that we had and the prosecutive team came to the conclusion as I said before, that we identified the intellectual authors of the operation but the people that you are talking about, I will repeat, it was the judgment of the investigative team that the evidence did not exist according to our standards to proceed for indictment. Had we done that we should have been kicked out of office for violating our oath and chasing people without evidence.

Senator METZENBAUM. Were you aware of the memo from Ball, to regional vice presidents and sales managers, dated October 27, 1980, in which he talks about this is a well-written primer on cash management for the branch office an then that follows with a memo from Joe McAdams and Gene McAllen, to all branches and satellite managers dated October 21, 1980?

Mr. TROTT. I remember.

Senator **Metzenbaum**. And under that, there is the heading overdraft the branch's bank account. Overdraft the branch's bank account. A memo on this subject was sent to all branch office managers on October 7, 1980.

Mr. **Murray**. Yes, I am fully aware of that. I had that document prior to the conclusion of the grand jury's investigation. I am aware of that memo that is referring to the theory of recapturing float within the banking system. What that memorandum—as I recall what that memorandum is, is regarding the general ledger interest credits which are earned as a result of credit balances on Hutton's books. That overdrafting does not relate to the overdrafting in regard to an actual bank overdraft or a collected overdraft. What that relates to is the Hutton book overdraft which, in fact, may have no legal significance regarding——

Senator **Metzenbaum**. Mr. Murray, if you handled this case totally in the manner in which you just answered that question, then you should have been removed from the case. Because the language just does not agree with what you just said.

Following our suggestions that could increase your interest profits. Now, that has to do with profits. That is not a matter of handling the company's own interrelationship.

It goes on to say, that No. 1, develop short sales. No. 2, develop more margin accounts. No. 3, improve branch profitability.

Mr. **Murray**. Right

Senator **Metzenbaum**. No. 4, overdraft the branches bank account. A memo on this subject was sent to all branch office managers on October 7, 1980.

Mr. **Murray**. But it does not refer to the overdrafting that you are trying to equate with being illegal. Short sales and margin and other interest creating activities does not relate——

Senator **Metzenbaum**. They are different items in this memo. I am talking about item No. 4, which has only to do with the overdrafting of the branch's bank account.

Mr. **Murray**. Maybe I can give you an example.

Senator **Metzenbaum**. You do not have to give me an example. I think that I understand English as well as you do, sir.

Mr. **Murray**. No, I am not saying that.

Senator **Metzenbaum**. Let me give you another one.

In the memo that was released August 1——

Mr. **Murray**. Excuse me, excuse me, may I just mention this?

With all due respect, please Senator, this is——

Senator **Metzenbaum**. Go ahead.

Mr. **Murray**. This is my first time being here, and with all due respects that you are a U.S. Senator and all, please, I just want to make it known to you that the overdrafting that is mentioned there is a very technical term.

Senator **Metzenbaum**. How do you know that?

Mr. **Murray**. Because I researched it for 3 years.

Senator **Metzenbaum**. Well, did you see the October 7, 1980 draft?

Mr. **Murray**. Yes.

Senator **Metzenbaum**. Let me see it, do you have it with you?

Mr. **Murray**. No, I do not.

Senator **Metzenbaum**. What did it say?

Mr. MURRAY. I believe that it related to the interest that is earned on short sales, on margin accounts, as a matter of fact, free-credit balances that are earned on stock certificates from the customers. I believe that it relates to the general ledger overdrafting of the bank account. I believe it also relates to—there are three other areas or four other areas of profitability.

Senator METZENBAUM. Mr Murray, it relates to——

Mr. MURRAY. Out of 7 million documents, I remember that document as well as other documents.

Senator METZENBAUM. But, Mr. Murray, you do not seem to understand.

Mr. MURRAY. Yes, sir?

Senator METZENBAUM. The following are suggestions that could increase your interest profits.

Mr. MURRAY. That is correct.

Senator METZENBAUM. And it does refer to other matters, like developing short sales.

Mr. MURRAY. Right.

Senator METZENBAUM. And developing more margin accounts. And improving branch profitability and ensuring that the case reserve is liquidated on settlement date, and not on the extension date.

Mr. MURRAY. That is correct.

Senator METZENBAUM. And always paid BOA drafts rather than local checks.

Mr. MURRAY. That relates to disbursement accounts.

Senator METZENBAUM. But the one point that relates to the intent to overdraft the branch's bank account is spelled out in English.

Mr. TROTT. What kind of overdrafting are they talking about, Senator?

Senator METZENBAUM. That is the interesting point. You said that it related only to certain kinds of overdrafts. He does not do anything about that. He just says, overdraft of bank's account.

Mr. CLARK. If I want to secure a conviction of Mr. Ball, Senator, I have to prove that it is one of those two types of overdrafting that we consider to be illegal and so charged in the criminal information: Arbitrary overdrafts and chaining. Unless I can prove, Senator, that Mr. Ball knew, when he used that term overdrafting and if I could prove, I must be able to prove, that he knew when he used that term, that he was speaking of and considering those kinds of overdrafting, not target balancing, not seeking to have their bank balances zero on an average basis. I must prove that he has done a criminal form of overdrafting or knew about it or authorized it or directed somebody.

Senator METZENBAUM. How about the April 23, 1980 memo to George Ball from Tom Willis, aid to the comptroller? Both offices, Washington, DC and Casper, WY, have one thing in common. They overdraft substantially through Bill Sullivan in New York. At 20 percent interest it is a very profitable product for the branches. He knew about it, did he not?

Mr. CLARK. Target balancing was very profitable, Senator.

Senator METZENBAUM. Pardon?

Mr. CLARK. Target balancing was very profitable.

Senator METZENBAUM. Target balancing or overdrafting?

Mr. MURRAY. It is the same thing.

Mr. CLARK. Target balancing is a type of overdrafting, that is very common or was very common at that time.

Senator METZENBAUM. I am talking about overdrafting. They overdraft very substantially. I did not see anything about target balancing.

Mr. OGREN. But that is what the term means, Senator. In that context the chains and the excessive overdrafting had not even started at that point. The scheme that we charged had not even begun yet. That was the practice that we could not reach criminally. With all due respect, Senator, the *Williams* case took us out on that one and we gave it serious consideration and we have banned it via our injunction. It was not a viable theory. The evidence does not support it. And we are not going to charge people with crimes when we do not have the evidence to prove it. I do not care who does not like it, we are bound by our oath.

Mr. MURRAY. I might also add one little point.

Senator METZENBAUM. You may be bound by your oath, but if you have enough evidence to charge the corporation, and corporations are run by people; corporations do not run by themselves.

Mr. OGREN. Fine, but we do not have that evidence, Senator.

Senator METZENBAUM. The concern is that you did not do enough of a job to be able to prosecute the individuals and maybe you were just not that anxious to do it and that is the real concern of this whole hearing.

Mr. OGREN. Senator, I must say that that is something that I take personally as an affront. I have been in this business for 18 years. I prosecuted without favor and I really do not like hearing that.

Senator METZENBAUM. I have no idea what your responsibility was in this case, sir, but all I can say is that when you have a corporation as large as this, and no individual can be found to be prosecuted, you might lose it, but that does not mean that you should not go forward and prosecute it.

Mr. OGREN. That is not our standard of ethics, sir, and it is an unethical act, to do that. And I dare say that——

Senator METZENBAUM. What is unethical? To bring a prosecution that you lose?

Mr. OGREN. Bring one that you expect to lose because you do not have the evidence, Senator. Any time you have prosecutors in this country that bring cases without the evidence, they ought to be tried for crimes themselves, sir.

I am shocked at that suggestion.

Senator METZENBAUM. Nobody is suggesting that you bring a case that you expect to lose but the question is, whether or not you really wanted to win a case against the individuals or whether you were totally satisfied to close out the case against the corporation.

Mr. TROTT. Senator, the statement that you have made, if I can harken back about 2 hours ago, has about as much relevance to how this case was prosecuted as the proverbial tree falling in Canada. And I am frankly not going to sit here and allow what are functional insults—I am not saying that you are being deliberately insulting—functional insults of the career hard-working prosecutors. And I might take this opportunity to tell you that what I am extremely concerned with this case, is that with a micro-management at this detail which begins to go into things like unfounded allegations that you just made, I do not know how many prosecutors we are going to have ever write anything down again, or be willing to take on big cases when they are pilloried in public on the basis of nothing.

Senator **Metzenbaum**. You have to understand why this hearing is being held. This hearing is being held because there is a concern in the country as to why and how Hutton got off with only a corporate prosecution. I am not alone in that concern. Here is the Wall Street Journal, frontpage story, talking about the fact of Hutton memos show approval of overdrafts. Ex-President Ball cleared firm system to handle some checking accounts. And it goes on to talk about——

Mr. **Trott**. We do not prosecute on the basis of the Wall Street Journal.

Senator **Metzenbaum**. I understand that we do not do that. I am well aware of that, sir. But I also am saying to you that the people of this country do have a concern as to why this one, major corporation was able to get off in this case, and no individual was prosecuted.

Mr. **Trott**. Senator, they did not get off, No. 1. And No. 2, as I said before, this was a judgment call on our part. I will tell you that the judgments in this case, were not easy. They were difficult. They required the best thinking of which the Department of Justice was capable. And I remain notwithstanding your criticism, completely satisfied that these judgments were exercised in good faith by career people dedicated to the profession of prosecution based on the merits, the evidence, and the law, and nothing more.

And every time you begin to try to tell one of my people that they violated their oath and shied away from somebody because he was a hot-shot big-wig in a corporation, I am going to continue to tell you that you are wrong and that is horse-feathers.

Senator **Metzenbaum**. I am not telling you that. I am saying to you that the policy of this administration is not to be willing to prosecute white-collar criminals on an individual basis.

Mr. **Murray**. That is just not true.

Mr. **Trott**. That is absolute nonsense.

Senator **Metzenbaum**. And you showed me, sir, you gave me some hokum from the last time you were here, and you gave me a book and you said, look what we have done. And I looked through the book and there was not anything that you had done in there. There was not anything that you had done in there except prosecute some little low-level people who were absolute nobodies in this country. There were not any real white-collar criminals of any consequence, corporate criminals, that were prosecuted. So when you tell me that, that I am misleading you, you attempted to mislead me and gave me a book this big and I looked through it and there was not anything in there to speak about. So do not tell me, Mr. Trott, that I am attempting to mislead you.

Memo dated May 12, 1980, from May Lewis to the Comptroller, to Tom Morley, cash manager, citing example of the importance of a good branch cashier is just as important as an account executive.

For the months of January and February 1981, and many months before, a certain branch in our retail system had been earning a consistent $30,000 per month in interest just from overdrafting the bank account. George Ball attached a cover sheet, dated June 3, 1981, to the above memo to be circulated to the branch managers, and regional vice presidents and sales managers.

"A point well worth remembering and acting on."

Senator **Biden**. Can I suggest something? I think that it might be useful since you are all arguing about overdrafts, we have identified the three types of overdrafts. One, you conclude may be not illegal under the law—the overdraft that is designed to "target balancing" that type of overdraft is one that is legal or at best one that you did not believe there was anything in the law that would allow you to proceed against them, is that correct?

Mr. **Clark**. At that time.

Mr. **Murray**. That only relates from a criminal standpoint and criminal intent.

Senator **Biden**. Let me try to help you, will you?

Mr. **Clark**. Forgive us if we are naturally suspicious.

Senator **Biden**. I understand that.

Mr. **Murray**. And I am an independent. I am not a Republican or a Democrat.

Senator **Biden**. There are three kinds of overdrafts that you were focusing on. One type of overdraft was target balance overdraft. Would you define what you mean when you use the term, target balancing, that type of overdrafting? What is that, explain it to me, and Senator Metzenbaum and for the record.

Mr. **Clark**. The practice as we came to understand it, Senator, was the drafting of checks, the writing of checks in excess of bank balances on certain days so as on a weekly or a monthly average to achieve a zero balance in that account.

Because, and the reason for it, I think I can make that equally simple, the reason is that an item that is deposited in for example, the Hutton checking account in a branch in whatever that town was in Pennsylvania, Shamokin, on a Thursday or a Friday might not clear and the bank may hold what Hutton, at least, considered to be its money for a period of Friday and Saturday and maybe if there was a holiday on a Monday——

Senator **Biden**. Thereby obtaining the advantage of using their money which in fact, they earn money on.

Mr. **Clark**. So what they would do, using a formula, and a drawdown sheet, was that they would take out more money than they had. When I say take-out more money, draft a check in excess of what their balance actually was in that account on certain other days in the week so as to balance out and achieve a target level of zero in the account for a cyclical period.

Senator **Biden**. Now, if you knew that someone said to the branch manager, or that a system was devised, forget E.F. Hutton, just Joe Biden Co.—my money manager says in a memo to me, I have devised a system that not only recaptures our money and gives us to a zero balance over a period of a day or a week or a month, but I have devised a system that can capture some of the bank's money so that at the end of the day, the week, or the month, we will have had the use of their money like the so and so's had been doing to us.

Would that be an illegal practice if implemented?

Mr. **Clark**. It depends on how he did it.

Mr. **Murray**. May I answer that too?

Senator **Biden**. If the end result is—take them one at a time, you can answer all that you want. It depends on if they in fact, did do it in the following way.

Mr. **Clark**. Let me just say one thing.

Senator **Biden**. Sure.

Mr. **Clark**. I think that I agree with you and the answer is "yes," but the reason why, and I think that I can make this very simple, the reason why target balancing, I am not giving away any secrets, the reason why target balancing was difficult if not impossible to prosecute, we concluded that it was impossible to prosecute at that time, was that what you would end up presenting to a jury would be evidence of the intent of individuals and the corporation at Hutton, to draw their bank balances down to zero, a level of zero, a constant level of zero, balancing out for those weekends.

Their intention was not to draw overdraw, if that system is in its pristine nature, not to draw out a penny more so that their average was not one cent less than zero on average.

Now, if you posit that that is what the evidence is, an intention to go below zero, even a penny below zero, then I think that we are in an area where we agree that the possibility was that we could prosecute.

Senator **Biden**. Now, if, in fact, the evidence was that you could establish and show that they, in fact, had consistently over 6 months or a year, the Biden Company now, that over 6 months or a year, in fact, had drawn down on average 20 or 30 percent below the target balance, that is, that they had consistently gone way over, if that had been established, would that not have provided sufficient evidence to establish criminal intent?

Mr. **Clark**. That is precisely what they did in the instances involving chaining and the arbitrary——

Senator **Biden**. I am just trying to make sure that we are all talking about the same things when we talk about overdrafting.

Mr. **Clark**. What you are describing is the result that is achieved by the use of excessive arbitrary overdrafts on the one hand or chaining on the other.

Senator **Biden**. Right, now the process by which one would say, if I directed my manager, my branch managers of the Joe Biden Co. to do the following: draw down not only the deposits plus anticipated deposits, but also bogus deposits, one day prior to that incremental draw down arriving at our bank, we may need to cover with a New York check. As long as the local bank honors that check with the same day availability, the firm profits at the branch and at the national level. The obvious draw-back of this system is that it can cost the bank a lot of money. If the bank honors the New York check with the same day availability and subsequently have those funds withdrawn from the New York draw-down check before they get to the Fed useage for the funds, they have a net debit.

Now, if that process whatever for the sake—I know what chaining is, and I know what you are talking about but let us make sure for the record, because——

Mr. CLARK. That is not chaining. That is Mr. Bacon's memo to Mr. Braylove and it is excessive overdrafting.

Senator BIDEN. Excessive overdrafting is, in fact, illegal, is it not?

Mr. CLARK. In that instance, yes, it was.

Senator BIDEN. In this instance, it is. OK, now, so we talk about the overdraft as target to zero and we talk about the excessive overdraft and we talk about chaining.

Now, explain chaining.

Mr. CLARK. Mr. Murray is more qualified to explain chaining.

Mr. MURRAY. OK, maybe I might go back and really clarify——

Senator BIDEN. No, just explain chaining: please. I am not kidding.

Senator HATCH. Take whatever time you need.

Mr. MURRAY. Senator Biden explained what recapture of float was and that is based upon, depends upon what the bank if any, whether or not the bank knew what the collected balance in the account was. If, in fact, there was not a collected balance in the account, and it does not necessarily mean that there was a scheme to defraud or an illegal conduct. You simply cannot make it that simple. That is what we would have faced at trial by experts.

Now, I explained to you what chaining is and I will not go back over it. And I do not want you to get annoyed with me, but you have to know what was going on.

Senator BIDEN. I know.

Mr. MURRAY. I think that you appreciate but I think that neither you nor I are experts in financial field and I am going to tell you what—I talked to the experts. I am trying to help everybody.

Senator BIDEN. I do not need help, thank you.

Senator HATCH. Go ahead and explain what chaining is.

Mr. MURRAY. Chaining was a system whereby multiple deposit locations were strung together and superimposed over on top of the draw down sheet. The draw down sheet was designed to target balance that Peter has just indicated.

What happened would be is that an original deposit in the bottom location of the local branches that are shown here, of say, $500 in a branch would ultimately be put in the regional location, the $500, and be concentrated in Manufacturer's Hanover Trust Co. in a prime bank at $500. What that does is create overall float in the banking system in the amount of $1,500. On the next day, in the event the check did not clear, on that second day, the draw down check would not clear in one day, what would happen you would have the ultimate effect of having now, $3,000 in the banking system.

And what, in fact, would happen—although that not be collected, it is not Hutton's money until the actual checks are collected. And it is not the bank's money until it is collected and that is why recapturing float takes on a different atmosphere.

In order to create more cash in the banking system, what Hutton did is that it created not three deposit locations going vertically, but did so horizontally and strung out the deposit locations so that instead of three, what would occur, you would have five deposit locations of $500 and therefore, it would be $2,500, depending upon the 1-day, 2-day, 3-day availability of the checks clearing the system, you would have the value of that float becoming an investment potential for the company.

Now, the problem with that, as far as proving illegality or a fraud would be is whether or not the zero balance accounts that were used to cover the overdrafts would be considered to be an actual credit card, or an actual funds on deposit. Or whether, in fact, it had any value whatsoever. So, what, in fact, you could do, Hutton was taking $500 and making $5,000 out of it.

Now, that is what I explained had to do with the fabric and tears in the fabric. They look for points within our payments mechanism, where Federal Reserve float existed and what they did, as other firms do and are doing right now, is that they went after those locations aggressively and they took the money and pushed it through those locations so that it tore that fabric.

What we did is that we designed a theory whereby we thought that, in fact——

Senator **Biden**. I know your theory.

Mr. **Murray** [continuing]. That was, in fact, illegal, that is chaining. And that is why we thought that chaining was unlawful and I do not mean to bore you with it, but that is the intracacies as simply as I can put it. But there is a lot more to it.

Senator **Biden**. Do you not usually pay interest on a credit card?

Mr. **Murray**. It depends upon your relationship with your bank. If you have two—yes, you do and that was the crux of our case, is that a demand deposit is a checking account in which you do not pay interest and that they were using these accounts as interest bearing accounts.

Mr. **Clark**. You do because the credit card company agreed with you and you agreed with them when you opened up your account with the credit card company that you would be charged interest and you would pay it.

They did not have that agreement with these banks.

Senator **Biden**. Is it not safe to assume that unless there was an assertion by the bank that they had given permission for there not to be the payment of interest, that, in fact, it was illegal?

How can the answer to that be anything but yes?

Mr. **Clark**. I think the question may be a little awkward, but if what you mean is that the banks did not consent to it we agree. They did not.

Senator **Biden**. And if they did not consent to it, it is illegal, is it not?

Mr. **Murray**. It may constitute one of the elements of the fraud.

Senator **Biden**. It may constitute taking, conversion.

Mr. **Murray**. No, it may constitute a portion of the evidence designed to create a scheme to defraud in the banking system circumstantially. You must look beyond the actual transaction to the intent of the parties doing the transaction.

Senator **Biden**. I give up. It is good to have you here, Orrin. Nice seeing you all.

Senator **Hatch**. Let me ask one question.

Senator **Biden**. I have no more questions for either of you.

Senator **Hatch**. Then I will let these witnesses go. You have been here for 3 hours.

Senator **Biden**. You have done an admirable job.

Senator **Hatch**. We have been happy to have you here.

This is a rare occasion in the Judiciary Committee. Even when Jimmy Carter was President, Senator Metzenbaum did not agree with the Justice Department very often. I commend all of you.

Mr. **Clark**. Thank you.

Senator **Hatch**. Thank you for coming.

We appreciate it.

Our next witness will be panel two. Mr. Robert Fomon, chairman of the board of E.F. Hutton, New York, NY, and Robert Ritterreiser, president of E.F. Hutton from New York, NY, and George Ball, corporate executive officer of Prudential Bache, New York, NY.

We are very happy to welcome all of you to the witness table here today and we look forward to taking your testimony.

TESTIMONY OF PANEL CONSISTING OF ROBERT FOMON, CHAIRMAN OF THE BOARD, E.F. HUTTON, NEW YORK, NY; ROBERT RITTERREISER, PRESIDENT, E.F. HUTTON, NEW YORK, NY, ACCOMPANIED BY WARREN CHRISTOPHER, COUNSEL, O'MELVENY & MYERS

Senator **Metzenbaum**. Mr. Chairman, I am going to excuse myself and I do not want these witnesses to feel that I am intending to slight them. I happen to have another commitment that I must be at.

But I am frank to say that my attendance at this hearing and my participation really is not to question their activities. They did what they thought they should do. That matter is concluded.

My question had to do with the Department of Justice and I have had an opportunity to question them, but I do not mean to walk out in a slighting way.

Senator **Hatch**. Thank you, Senator Metzenbaum.

Let us begin with Mr. Fomon, and we will go with you first and take your statement and then Mr. Ritterreiser.

Mr. **Fomon**. Well, I would like to read what was a five-page statement and I have reduced it to two pages.

Mr. Chairman, and members of this committee, I am here to cooperate fully with your inquiry.

In addition, Senator Biden has asked me to consider whether the deterrent effect of the law is sufficient to inspire compliance by large institutions. In that respect you may find securities firms are a special case. We are already subject to many unique forms of external control, a specialized Federal agency, the Securities and Exchange Commission regulates our conduct. We are audited annually by the New York Stock Exchange, to monitor compliance with Exchange rules and securities laws.

Since our business depends upon trust, most securities firms, including ours, have special systems of internal audits to assure compliance with statutes and regulations protecting our customers.

As soon as senior management learned of the cash concentration problem, we took steps to see that all such practices were ended.

They stopped in early 1982. And in that context, deterrence did work from the outset, in the sense that the investigation itself, the threat of prosecution alone, brought the challenged conduct to a stop.

The steps we have taken since the plea agreement stand as forceful testimony to our determination that there will be no repetition of these problems.

I also think that any American business whose operations involve cash management, will see our case as a strong object lesson.

The costs of the formal penalty negotiated with Justice are well known. We have also faced other investigations and enforcement actions and shareholders' derivative and class actions.

Our own voluntary steps since the settlement are less well known. Since that time, we, at Hutton, have taken aggressive new steps on our own to guard against wrong-doing.

They are described in some detail in a letter which I have recently sent to Chairman Hughes of the House subcommittee which I have also provided to the committee so that I will not summarize it here.

Given the many unique circumstances of our industry in this case, I think it is fair to conclude that law enforcement has worked here to inspire far reaching reform that will forestall any recurrence in our company and perhaps more broadly in the industry as well.

Our entire management group at Hutton shares a determination that E.F. Hutton will be a good corporate citizen. Since discovery of the mistakes that were made prior to 1982, E.F. Hutton has responded properly and conscientiously. We have made certain that that will never happen again. And we have gone further to ensure that we will not only meet the minimum standards the law requires, but the high ethical standards we feel our clients, the public, and our employees deserve.

That is the end of my statement.

Senator HATCH. Senator Biden, would it be agreeable for the entire statement to go into the record?

Senator BIDEN. I have no objections.

STATEMENT OF ROBERT RITTERREISER

Mr. RITTERREISER. My name is Bob Ritterreiser and I am president of E.F. Hutton. I joined the firm on July 1, 1985, and I certainly associate myself with the comments made by the chairman.

Senator BIDEN. I have a couple of questions, if I may?

Some for you Mr. Fomon and then some for you Mr. Ritterreiser, even though you were not at the company at the time.

I am going to ask you, Mr. Ritterreiser about what has happened since you have come on board.

Mr. Ball is the only one who has not been sworn.

Mr. Fomon, did your company commit a criminal act, in your mind?

Were any of the types of overdrafting that were described here, and you sat through the testimony, in your mind, were they criminal conduct?

Mr. Fomon. I do not know if they were criminal or not, they were certainly unethical.

Senator Biden. Why did you plead guilty?

I guess I should back up that is not fair.

Who made the decision that the company would, in fact, plead guilty?

Mr. Fomon. The entire board of directors unanimously.

Senator Biden. And why did they share your view that although that it was unethical but it may not be criminal?

Mr. Fomon. I do not know. The reason we pleaded guilty was that we thought it would get the situation behind us and get us out of the media. We were told if we were to go to trial it would last for years. We were led to believe by the lawyers that this was the way to put it to bed. I never dreamed nor did anyone else dream that it would be such a cause celebre, and be such a big issue which, of course, was prompted by the investigation by the Subcommittee on Crime.

Senator Biden. Knowing what you know now, would you have recommended that your company plead guilty? That is, knowing what happened in the aftermath of the whole thing, would you have recommended that your company plead guilty?

Mr. Fomon. I would not have entered into the plea agreement.

Senator Biden. I have lot of questions.

Senator Hatch. Let me ask one question, if you do not mind.

Senator Biden. No, please go ahead.

Senator Hatch. One of the main contentions of E.F. Hutton throughout the investigation by the Justice Department is that none of the challenged practices was, in fact, illegal.

How much to you attribute ambiguities in the law to your inability, and for that matter, the inability of numerous brokerage houses to clearly define what was or was not permissible money management? What further refinements in the law are necessary in order to comply?

Mr. Fomon. I do not know that there was any law in this area. I think that what the Justice Department was attempting to do was write law as a result of our plea aggreement.

Senator Hatch. Would you recommend that any refinements in the law?

Mr. Fomon. Well, I think that if the industry were required to share with the banks. their cash concentration methods, that would be very helpful. We are now informing every bank of how our cash concentration system works.

Senator Hatch. What internal changes have occurred at Hutton which would give this committee confidence that you are able to police yourselves? What internal changes have you made to prevent a recurrence of these sort of violations?

Mr. Ritterreiser. Well, numerous steps have been taken, some of which have included reorganization of personnel and reassignment of responsibilities, the development of computerized systems to further monitor the activity, and as Mr. Formon just pointed out, entering into formal agreements with the banks so that there is a full explicit understanding between the firm and any banks processing our funds. In addition, the reassignment of financial audits within the organization under a chief financial officer, and expansion of those activities beyond what was perceived to be an adequate scope prior to that. The audits have been expanded beyond that level in order to look more at the broader picture on the activity, rather than just at the individual details.

Senator **Hatch**. Do you have any program for training your employees?

Mr. **Rittereiser**. We have expanded our training program but in addition to that, we have conducted a training program on this entire area throughout the entire organization, throughout last summer. Several thousand employees, many of whom are simply in the processing loop, were subjected to a full training program.

Senator **Hatch**. In your opinion, what was the impact upon the brokerage community of this type of investigation and plea agreement?

Mr. **Ritterreiser**. Well, I was at Merrill Lynch when this occurred. And reading in the press reports and whatever else we could learn about it, we immediately did a review of our own processing to ensure that we were not doing what would be perceived to be improper. We just double checked ourselves and that review was still ongoing when I left Merrill Lynch. The indications that I had, at that time, indicated there were absolutely no problems. But nevertheless, I think the key behavior was that we double checked ourselves and I am sure that every other firm double checked itself just as much as corporate America probably did.

Senator **Hatch**. Would you give the members of this committee any ideas that you might have concerning laws that we should pass with regard to money management? How might this committee assist the brokerage community in the future?

Mr. **Fomon**. I cannot speak for all of American industry. I think, as I mentioned in my opening remarks, the securities industry is different because it is already so highly regulated. I think what we are really talking about is not more laws, but a matter of ethics and ethics is something that I always thought that you learned as a child from your parents or you learned it at church or in school or somewhere else.

But you have to realize that some people do not. Ethics is something that can be taught and has to be taught and continually retaught in corporate America today. And it is not just a matter of coming up with a code of ethics, because any number of companies in the last 10 years have adopted codes. However those codes are generalizations and generally prohibitions of performance activity of employees.

The codes have to have hypotheticals incorporated in them which actually would help an employee make a decision. A code of puritanical statements does not accomplish very much.

Senator **Hatch**. Let me turn the time over to Senator Biden.

Senator **Biden**. Thank you very much.

Mr. Fomon, what was the unethical thing that was done? What was the unethical conduct to which you refer?

Mr. **Fomon**. In the concentration system?

Senator **Biden**. Yes.

Mr. **Fomon**. The adding of zeros to deposits.

Senator **Biden**. I am sorry, sir, I was distracted.

Mr. **Fomon**. The adding of zeros to deposits to inflate——

Senator BIDEN. Could you explain what that means?

Mr. FOMON. Well, certain branches inflated their deposits by adding a zero. If it were a $100 deposit, they made it $1,000.

Senator BIDEN. How did they do that?

Mr. FOMON. Well, if they took in a $100 they simply wrote a check for a $1,000.

Senator BIDEN. On another bank?

Mr. FOMON. Yes.

Senator BIDEN. That was the essence of what was unethical?

Mr. FOMON. No, I think the chaining was unethical. I mean there was no reason to move deposits laterally across five banks. I would question that from an ethical standpoint.

Senator BIDEN. I know your lawyer, too well, and this is not a game of trickery.

Just so that you understand where I am going. As far as I am concerned, E.F. Hutton matter is over and closed but what is open is whether the Justice Department knows how to use the laws that are applicable to this sort of conduct. You are one of 10 or 12 companies which I decided from this Senator's standpoint, I am going to investigate how they deal with them for the purpose of determining whether or not, first, they know what they are doing, and second, if they do not know what they are doing, how to change it, and third, if they do know what they are doing, what new laws they may need to do better.

So, that is the context in which I ask these questions.

And I promise you and if you think that I am about to sandbag you and be in for cross-examination then put your hand up and I will rephrase the question.

Mr. RITTERREISER. I would describe it in this way: in the use of a system that people perceive to operate a certain way, they exercise judgment or follow practices that, in the end, use the system in a way that was unintended. That behavior in the end——

Senator BIDEN. The system was intended, not the behavior?

Mr. RITTERREISER. They took advantage of the way a system operated for themselves or for what they perceived to be, perhaps, for the firm's benefit or for their benefit, and that was the unethical practice that was engaged in.

Senator BIDEN. Was there any doubt that the firm benefited at the time?

Mr. FOMON. Well, the firm benefited but not to the extent that everyone thinks.

Mr. RITTERREISER. It was monetary benefit.

Senator BIDEN. To what extent do you think that there was monetary benefit?

Mr. FOMON. Well, the total amount of claims put in by banks under the restitution program that have been paid is about $3 million and yet, there were people making irresponsible statements that our reserve of $8 million was hardly enough. They said it should be $50 million.

Senator BIDEN. How many claims were not put in under the restitution program, that is, how many banks came to you and said, "Let's you and I make a deal here?" Did anybody seek restitution outside of the restitution program that the Justice Department had you sign on to?

Mr. **Fomon**. Well, there are some unresolved claims. I do not have the exact statistics on this, do you?

Mr. **Ritterreiser**. I do not have the exact numbers in front of me.

STATEMENT OF WARREN CHRISTOPHER

Mr. **Christopher**. Senator, the information I have indicates that five banks are seeking to recover something from the company outside the restitution program and those claims are, as yet, unresolved.

Senator **Biden**. Are there any suits that are outstanding?

Mr. **Christopher**. One of those had preceded to the point of lawsuit.

Mr. **Ritterreiser**. I agree with that.

Senator **Biden**. Would you continue to use a bank as a depository if they came in to you and claimed restitution?

Mr. **Ritterreiser**. Yes, and in almost all of these cases, the relationship with the banks have continued.

Mr. **Fomon**. I think in all the cases.

Senator **Biden**. I must tell you and I plain to have a long discussion with former Attorney General Bell about this, for I find the assertion unsupportable, that because under restitution clause, only $8 million was set up for restitution and less has been asked for, I gather, and that ipso facto that means that, in fact, that the amount of money that E.F. Hutton benefited from what is acknowledged to be an unethical scheme, was not very high. But that is not something that I will go into now.

Mr. **Fomon**. Well, we did encourage the banks to come in for restitution and if we did not hear from them on the first contact, we went back to them a second time.

Senator **Biden**. Let me ask you the question this way. I did not plan on pursuing this but you are under oath.

Can you honestly say to me under oath that you believe that the benefit, financial benefit obtained by E.F. Hutton Co. from the practices that you describe as unethical did not much exceed $3 million?

Mr. **Fomon**. I have no way, Senator, of knowing what it would be. The only way I can judge it is based on what the banks tell us.

Senator **Biden**. Well, OK. You had no way of going back to your management system to determine benefit that flowed from the unethical practice?

Mr. **Fomon**. At the time we set up the reserve for the restitution, our best estimate was that $8 million including interest would cover more than all of the improprieties.

Mr. **Ritterreiser**. Senator, my understanding is that that work was done before I joined the firm, but I understand it was done based on an attempt to go back and analyze the difference between actual balances and overdrawn balances. And it was on that basis that that reserve was determined, and it was on that basis that the potential banks were identified and the materials drafted to give them the ability to do a similar reconciliation to come back to make a claim.

Senator BIDEN. Would you consider sharing with this committee for the record the method by which you arrived at that calculation?

For example, as I sat down and did it, without the numbers, the process, and tell me whether or not this is an inappropriate way to calculate, quote, the unethical profits that were made, unquote.

Mr. FOMON. Sure. I will share with you any records we have.

Senator BIDEN. Well, I do not need many more records. If you will just do that; just how you came up with the calculation.

For example, it would seem to me that if you were to take the checks written on the New York zero balance account and added up the gross figure; from that subtract what you believe to be ethical usages; that is, the customer's check returned for insufficient funds that were totaled in there and the amount was included to recover float the bank was benefiting from——

Mr. FOMON. Senator Biden, I think Mr. Murray misled you. On zero balance accounts, I believe we pay interest to the bank on any check that is drawn on that account. I mean, banks just do not let us have zero balance accounts without their earning some money on them. So there is no cost to a bank on a zero balance account.

Senator BIDEN. That is correct, but the way—if you will share with us the method by which you arrived at that.

Mr. RITTERREISER. We will be happy to do that.

Senator BIDEN. Now, let me ask you: Again, the unethical conduct as you view it is the adding of the zeros, to use your phrase, which is essentially the appropriation for as short a period—whatever that period might be. It may be a day, it may be 2 days, it may be 3 days—of, "the bank's money." And that is the unethical part, right?

Mr. FOMON. Yes.

Senator BIDEN. Now, how is that different than someone coming in and—how can I approach this?

What does a bank have that makes its money? It essentially rents people its money, does it not? I mean, is that not how it makes its money, by and large, other than services that it provides?

Mr. RITTERREISER. Basically. It either has money to use for relending or it purchases money at one rate and sells it at another rate; rents it at one rate and re-rents it at another rate.

And to the extent that money is left there free, that is of no cost to them, that gives them obviously a greater profit margin.

Senator BIDEN. All right. And to the extent that more money is taken from them, it gives them a lower profit margin. Money that is not left, that is drawn down to zero?

Mr. RITTERREISER. If it is drawn to zero, that is right. They do not have the use of it, and the person who owns the money has use of it.

Senator BIDEN. That is right. But if it is drawn down below zero.

Mr. RITTERREISER. If it drawn down below zero, then that party has crossed the line. That is where the adding of the zeros crossed the line.

Senator BIDEN. Right. And that is unethical, as you state.

Now, I do not understand how that is different, the adding of the zeros is any different than to my walking into a rental company, borrowing their tools, using it, doing no damage to it, and bringing it back at the end of the weekend but not paying them for it. Where I come from that is called "theft." Under the statutes, that is a "theft." That is a conversion of property which is owned, from which the owner could benefit, and I deny to him the benefit.

Mr. FOMON. It is probably not different.

Senator BIDEN. That is what I thought, too.

Now, Mr. Fomon, for the record, did you know of this adding of the zeros?

Mr. FOMON. Of course not.

Senator BIDEN. And had you known, would you have stopped it?

Mr. FOMON. Absolutely.

Senator BIDEN. When you left the grand jury in November 1984, was it your belief that any individuals in the company were going to be indicted? What was your feeling as you walked out of that, if you would be willing to share it with us?

Mr. FOMON. Well, I was told that I was not a target, and I was interested in myself, naturally.

Senator BIDEN. I would have been too. I am not being smart. That would have been my first thought walking out.

Mr. FOMON. And I do not recall any conversations about anyone else.

Senator BIDEN. You know, there is a lot of controversy about your meeting with Attorney General Smith.

Mr. FOMON. I know and I have told that story any number of times. And I do not really see what was so terrible about it. I guess I am naive, but when I have a problem with another securities firm or General Motors or any corporation, I am used to calling the chief executive officer. And that is the basis on which I talked to Smith. I did not ask Smith to enter into any negotiations on the subject. I would not have embarrassed him by attempting to enter into any kind of negotiations involving him.

Senator BIDEN. What was your purpose? Just so he was informed, it did not get out of hand?

Mr. FOMON. No. The purpose was that the lawyers told me that we had been told we were going to be indicted by Murray, that we had wanted to make submissions to Washington, and that we were afraid that we would be indicted before we were able to make all the submissions to Washington.

Senator BIDEN. It was Mr. Moorhead that told you this?

Mr. FOMON. Pardon?

Senator BIDEN. Who told you this?

Mr. FOMON. Our lawyers.

Senator BIDEN. Who is Mr. Moorhead?

Mr. FOMON. No, no. He was my administrative assistant.

Senator BIDEN. Who is Mr. Moorhead?

Mr. FOMON. He is my administrative assistant.

Senator BIDEN. OK. All right.

Mr. FOMON. So the grand jury had just a few more days to run, and we anticipated an indictment before we had a chance to make these submissions.

Senator BIDEN. Did you pick up the phone and call Smith or did your assistant pick up the phone and call his assistant and ask for a meeting?

Mr. Fomon. No. My assistant, who is sitting in the back room if you want him to testify——

Senator Biden. I will believe you.

Mr. Fomon. OK. I asked him to make an appointment with Mr. Smith for lunch. My assistant knows both Mrs. Smith and Mr. Smith. He knows Mrs. Smith better. He called Mrs. Smith and said I was going to be in Washington and could we have lunch.

And I asked him to set it up as a social lunch.

Senator Biden. Now, your objective was not to get the Attorney General to negotiate, just to make sure you had an opportunity, to the extent you could, for your corporation to get all the submissions in—

Mr. Fomon. Correct.

Senator Biden [continuing]. Before they would sign a writ.

Mr. Fomon. Right.

Senator Biden. Now, I am almost finished here.

There was a lot of hubbub, as you know, today about this fellow Perry H. Bacon. I do not know which one of you would be the one to answer the question, but explain to us how and why he was paid $600,000. Is the newspaper article correct, that he was paid $600,000 severance pay?

Mr. Ritterreiser. That article, I believe, was quoting from a document that was in a divorce filing. I would be glad to comment on the Perry Bacon situation.

Senator Biden. It would be helpful.

Mr. Ritterreiser. OK. As I mentioned earlier, I joined the firm in July of 1985, and of course, the plea agreement was May 2. And at that point, subsequent to the annual meeting and, again, before I joined the firm, the decision was made to hire Judge Bell to review the entire situation and make recommendations to management about accountability and other factors. That decision was done and underway. And when I joined the firm, I was pretty much concentrating on trying to manage the business going forward.

It is a people business, expert-dependent business, and one that obviously counts to a great extent on the trust of the public.

In the context of that summer, there was a great deal of public focus on the company, and senior management was deeply involved, of course, in managing the affairs of what was a crisis environment. I took on the job of managing the company going forward, managing the operations going forward.

As the Judge Bell review continued, it was very clear that people were beginning to be under a great deal of pressure, unlike a grand jury situation where people are testifying quietly and secretly with no discussion. This was an internal review, and all along the way people who were doing their job were obviously being called for interviews. And it was a very tense, anxious time for everybody.

I decided in the context of that, having some degree of objectivity since I was not involved, to establish a policy, prior to the release of the Bell report, as to how we might go about making judgments about people affected by the Bell report. And I began to hypothesize what some of the conclusions could be. And it was clear that I did not know who would be involved, and I could only guess at the range of penalties that might be recommended by Judge Bell.

In the end there were a series of people identified and, in effect, recommendations made for their punishment. Prior to that, I had developed a policy that simply said if we believe it was in the firm's interest or the individual's interest to be separated from the company as a result of this activity, we would do so under a policy set that would give people roughly 1 year compensation going forward. We would pay them whatever they had earned through this year plus give them 1 year's separation, regardless of their level, and with some additional considerations for length of service over 6 years.

Senator BIDEN. And regardless of whether or not they were viewed as being highly unethical or not?

Mr. RITTERREISER. Again, the studv was being done. It was a very gray area. Nobody was convicted of a crime. It was a question, in many cases, of—

Senator BIDEN. But the company was. The company pled guilty.

Mr. RITTERREISER. The company was, but the individuals who were now under scrutiny were not. And there was a great deal of history involving the policy set. I looked at questions like the laws on wrongful dismissal. I had the aide of one of the leading labor attorneys who advised me somewhat on the areas of defamation of character. We are talking about people who in many cases had made judgment errors, clearly, and perhaps had been involved in unethical behavior. And then, in turn, I was going to make a judgment on them. If we judged their behavior to be egregious, we were not going to let them continue with the firm. It simply became a matter of what was a fair way to remove them from the company, to give them a chance to adjust to a new life, and separate from the firm. This would enable us to gather our forces and go forward in running the business from that point forward.

So we applied that policy to a number of people who, in fact in the end, asked for or chose the separation route, or where we in fact gave them the alternative of the separation route.

Senator BIDEN. Did Judge Bell recommend that this particular person be——

Mr. RITTERREISER. If I could just elaborate and finish.

Senator BIDEN. I did not mean to cut you off.

Mr. RITTERREISER. On Perry Bacon, he was one of the more highly paid individuals. He was a highly regarded employee for 9 years, and he was an extremely competent individual who had income levels that were at the $500,000 plus level. And he had a number of things that he was both contractually and otherwise entitled to, and these are the kind of things that were included, along with the 1-year's severance at that rate. And that is why the number is large and huge. I understand the public reaction to it, but in fact it was within the subset of policy that was developed under the circumstances.

Senator BIDEN. The part that bothers me about it, just so you know, is that as evidenced by the plea, at a minimum at least part of that huge income is being generated by what you all pled to as having been illegal activity, and you acknowledge it is an unethical activity. That is why I have difficulty with it.

Mr. RITTERREISER. Again, it is a judgment call.

Senator BIDEN. I understand your point.

Mr. Ritterreiser. If the person did not perceive it to be illegal but it was still unethical, those are two different judgments. And if you are sitting here making judgment about an employee and the conditions under which he performed his job and whether you had trust and confidence in going forward, that too is a judgment.

Senator Biden. Well, I do not want to belabor the point. You have made your point and I appreciate it.

Did Judge Bell recommend that he pay a $50,000 fine? Was that correct?

Mr. Ritterreiser. He recommended that the people in that branch office category pay a fine of between $25,000 and $50,000 to be determined by the board of directors.

Senator Biden. Did he pay any fine?

Mr. Ritterreiser. The board did impose a $25,000 fine, but Judge Bell recommended that if they left the company they would not have to pay the fine.

Senator Biden. So he did not pay the fine.

Mr. Ritterreiser. In the end he personally did not pay the fine.

Mr. Fomon. We are very conscious of this whole subject of wrongful termination. One of the men that we thought we had entered into a termination agreement with turned around and sued us for $20 million.

Mr. Ritterreiser. $20 million for defamation of character. So despite the fact that we did follow a set policy and tried to do it carefully and consistently and treat properly all employees the same who were affected this way, we did get at least partially some of the effects we had hoped to avoid.

Senator Biden. I have a couple more questions for you, Mr. Ritterreiser, and then I do not have any more questions.

Mr. Ritterreiser. Fine.

Senator Biden. I think you already answered this, but let me clarify the record. You were with Merrill Lynch.

Mr. Ritterreiser. That is right.

Senator Biden. In what capacity were you at Merrill Lynch?

Mr. Ritterreiser. When I left Merrill Lynch, I was chief administrative officer, executive vice president, chief financial officer.

Senator Biden. Now, were you engaged in adding zeros?

Mr. Ritterreiser. No, sir.

Senator Biden. How do you respond to the assertion made here today by Justice that everyone was doing it?

Mr. Ritterreiser. I do not agree with that. I do not agree that everybody was adding zeros. In fact, within E.F. Hutton not everybody was adding zeros. The number of people who did not follow the system in the way it was intended was only a relative handful. And the toughest part about this whole thing is the way that spilled over to 17,000 employees.

Senator Biden. From reading my notes; that is part of my conclusion.

Mr. Ritterreiser. As Mr. Fomon has said before, if this was a planned scheme, he would be a lot more efficient at it than just getting part of the organization to work that way. We normally can get people to work in full unison if we are trying to get something done.

Senator **Biden**. It seems to me, Mr. Ritterreiser, that you face a fairly formidable task. E.F. Hutton is obviously one of the major financial institutions in this country. The interest income system consciously established and activated by at least some at E.F. Hutton crossed the line from legal to illegal conduct.

It is amazing. I know we Senators are supposed to be fairly dense and stupid and not know much about things. I know within this branch we tend to think the administration—and they assume, I guess, that we do not understand things like float, but at a minimum, Hutton crossed the line. But, it seems to me that you are on your way to reconstructing confidence in this company in E.F. Hutton.

You have no notion of the shock wave that was sent through politics in my State which, by the way, is not unaccustomed to corporate America, and other places. Forget the number of labor union people or blue-collar workers or whatever, the number of businessmen that approach me with, What the heck are you letting them get away with? What is Justice doing?

And I really, truly appreciate, Mr. Fomon, I do not want you to misread me. I make no judgment about whether or not you knew. I accept your assertion you did not know. The purpose of my questioning today was—I must tell you, though, were I the Attorney General, I would have to use the technique of flipping employees to make sure beyond any doubt in my mind or not what you knew. I just want you to be clear about that. I have no illusions about it. I do not mean to suggest that I would not have, quote, gone after you, I would have. I would have gone after everyone in that company, but I accept the assertion you make today under oath. And I accept and appreciate the fact that you have answered forthrightly.

You know, the Justice Department skirted around for 3 hours that they do not know conversion from fraud. It is a kind of simple concept, but they had trouble with it.

I appreciate your straightforward answers, and I appreciate your straightforward assertion, Mr. Ritterreiser, about what in fact your predecessor employer did and did not do and you did not and whether everybody in the system does it.

As far as I am concerned, the only thing you are going to hear from me, you in an editorial sense, are additional questions put to Mr. Hughes, who is going to come and testify here, Congressman Hughes, and other questions put to Judge Bell.

I will say it for the record, so it is no surprise. I think some of the assertions in that report by Judge Bell are incredibly self-serving and somewhat disingenuous. I want to be on the record, so there is no surprise about that.

As far as I am concerned, other than that the matter ended for me as it relates to you.

I wish you well in re-establishing faith in the company, which you are on your way in doing with E.F. Hutton, and, quite frankly, all broker dealer operations across the country.

If there is any comment you would like to make, fine. I do not have any more questions.

Mr. **Fomon**. I want to thank you for that last comment.

Mr. **Ritterreiser**. Yes; me, too. We are looking to focusing on the future, and as Mr. Fomon said, we are and are going to be outstanding citizens. And we have a great commitment to our employees and our customers, and that is what we are going to push for going forward.

Senator **Hatch**. Well, thank you. I want to thank both of you for appearing. We appreciate the time you have given.

Mr. **Fomon**. Thank you.

Mr. **Ritterreiser**. Thank you.

[Aforementioned material follows:]

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United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510

April 1, 1986

Mr. Robert Foman
Chairman of the Board
E.F. Hutton
New York, NY 10004

Dear Mr. Foman:

I write to you in advance of the Judiciary Committee's scheduled hearing on the White-Collar crime hearings, in which you have been invited to testify, because I wanted you to have the opportunity to think over at least one question before your appearance.

In 1961, General Electric and 29 other electrical equipment manufacturers, who, together, controlled 95 percent of the market, were convicted of conspiracy to fix prices. The middle level executives, who were charged and convicted, said price-fixing in the industry was an established practice. The company presidents, who were neither charged nor convicted, said they were unaware of the practice.

Following the convictions, a number of civil suits were brought against the principal executives of the companies that charged mismanagement. One of the more prominent of the suits was *Graham v. Allis-Chalmers Mfg. Co.*, 41 Del. Ch. 78, 188 A2d 125 (1963). In *Graham*, the Court held that the executives were not civilly *liable* to the corporations for the damage done to the corporation by the conduct of their subordinates in fixing prices in the absence of a showing that they knew of the activity and failed to act. Similarly, they had no duty to institute a program within the company to uncover wrongdoing unless they had grounds to be suspicious that wrongdoing might be occurring. *Graham* followed the lead of the Supreme Court's decision in *Briggs v. Spaulding*, 141 U.S.132,145-42 (1891).

The *Briggs* decision , of course, was handed down at the end of the 19th century, and it reflected the wisdom of an era of laissez-faire capitalism and caveat emptor. My thought is to test its contemporary vitality with you in light of recent events and a new era with more concern for responsible conduct.

Repeatedly, studies have shown a disturbing pattern of corporate recidivism. In his classic study, in 1940, *White-Collar crime*, Edwin H. Sutherland examined seventy of the largest manufacturing mining and mercantile corporations in this country. Over an "individual life career" of forty-five years, the seventy corporations had an average of four criminal convictions each. Subsequent studies have found no difficulty in replicating Sutherland's findings. *See e.g., M. Clinard, Illegal Corporate Behavior* (1979). Indeed, I note that G.E. has only recently plead guilty to defrauding the United States in connection with the Minuteman missile program. In light of these studies, I wonder how valid it is to assume in large organizatons today that no action is required to anticipate, rather than to react to, wrongdoing by subordinates?

As I see it, the executive of a large organization faces, at the extreme, two courses of action, neither of which is attractive. He or she can centralize in his or her office most, if not all, of the crucial decisions of the organization, but lose the flexibility required in a free enterprise economy of on the spot decision-making. On the other hand, he or she may delegate to his or her subordinates most, if not all, of the crucial decision-making power in light of general policy standards and hold the subordinates responsible for achieving various corporate goals. While that course of action retains the benefit of decision-making near to the problem, it may divorce high level policy-makers in a corporate organization from information they need to protect the corporation from wrong doing by subordinates.

As a society, we have accorded great wealth and prestige to corporate leaders, and by and large, we have prospered as a nation by doing so. We give them credit for the successful economic performance of the organizations they head. Appropriately and fairly, should we not also hold them accountable for wrongdoing by the organization?

Do we need to rethink our standards of what constitutes good management techniques in large organizations in light of corporate wrong doing?

Do we need to change our legal standards of responsibility to assure that good management techniques are followed?

I look forward to your thoughts and suggestions.

Sincerely,

Joe Biden

Joseph R. Biden, Jr.
United States Senator

STATEMENT OF ROBERT FOMON, CHAIRMAN
E. F. HUTTON GROUP, INC.
SENATE COMMITTEE ON JUDICIARY
APRIL 17, 1986

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, I AM HERE TO COOPERATE FULLY WITH YOUR INQUIRY. IN ADDITION, SENATOR BIDEN HAS ASKED US TO CONSIDER WHETHER THE DETERRENT EFFECT OF THE LAW IS SUFFICIENT TO INSPIRE COMPLIANCE BY LARGE INSTITUTIONS.

IN THAT RESPECT YOU MAY FIND SECURITIES FIRMS ARE A SPECIAL CASE. WE ARE ALREADY SUBJECT TO MANY UNIQUE FORMS OF EXTERNAL CONTROL. A SPECIALIZED FEDERAL AGENCY, THE SECURITIES AND EXCHANGE COMMISSION, REGULATES OUR CONDUCT. WE ARE AUDITED ANNUALLY BY THE NEW YORK STOCK EXCHANGE, TO MONITOR COMPLIANCE WITH EXCHANGE RULES AND SECURITIES LAWS. SINCE OUR BUSINESS DEPENDS UPON TRUST, MOST SECURITIES FIRMS, INCLUDING OURS, HAVE A SPECIAL SYSTEM OF INTERNAL AUDITS TO ASSURE COMPLIANCE WITH STATUTES AND REGULATIONS PROTECTING OUR CUSTOMERS.

OF COURSE THE HUTTON CASE DID NOT INVOLVE PROBLEMS OF ANY KIND WITH CUSTOMER ACCOUNTS. SINCE CUSTOMER PROTECTION IS THE PRIMARY EMPHASIS OF THE VARIOUS INTERNAL AND EXTERNAL CONTROLS I HAVE JUST DESCRIBED, THEY DO NOT NECESSARILY REACH BANKING RELATIONSHIPS WHICH WERE INVOLVED IN THE HUTTON CASE.

AS SOON AS SENIOR MANAGEMENT LEARNED OF THE CASH CONCENTRATION PROBLEM, WE TOOK STEPS TO SEE THAT ALL SUCH PRACTICES WERE ENDED. THEY STOPPED IN EARLY 1982. IN THAT CONTEXT DETERRENCE DID WORK FROM THE OUTSET, IN THE SENSE THAT THE INVESTIGATION ITSELF -- THE THREAT OF PROSECUTION ALONE -- BROUGHT THE CHALLENGED CONDUCT TO A STOP.

THE STEPS WE HAVE TAKEN SINCE THE PLEA AGREEMENT STAND AS FORCEFUL TESTIMONY TO OUR DETERMINATION THAT THERE WILL BE NO REPETITION OF THESE PROBLEMS. I ALSO THINK ANY AMERICAN BUSINESS WHOSE OPERATIONS INVOLVE CASH MANAGEMENT WILL SEE OUR CASE AS A STRONG OBJECT LESSON.

THE COSTS OF THE FORMAL PENALTY NEGOTIATED WITH JUSTICE ARE WELL KNOWN. WE HAVE ALSO FACED OTHER INVESTIGATIONS AND ENFORCEMENT ACTIONS AND SHAREHOLDERS' DERIVATIVE AND CLASS ACTIONS.

WE HAVE COMPLIED WITH ALL PROVISIONS OF THE CONSENT DECREE ENTERED INTO WITH THE JUSTICE DEPARTMENT LAST MAY. WE ARE PLEASED THAT OUR BANK RESTITUTION PROGRAM IS NEARING COMPLETION. OF THE 113 BANKS WHICH ORIGINALLY REQUESTED PARTICIPATION, APPROXIMATELY ONE HALF DID NOT ULTIMATELY FILE A CLAIM. OF THOSE THAT FILED ACTUAL CLAIMS, ABOUT ONE HALF HAVE BEEN PAID, FOR A TOTAL OF $1,225,000, INCLUDING INTEREST ACCRUED SINCE THE 1980-82 PERIOD. ABOUT ONE FOURTH OF THE REMAINING CLAIMS WERE UNJUSTIFIED AND WERE DROPPED, AND THE OTHER ONE FOURTH ARE IN THE FINAL STAGES OF NEGOTIATION WITH THE COMPANY. WE EXPECT TO RESOLVE THESE OUTSTANDING CLAIMS BY JULY 1, 1986. TOTAL CLAIMS SUBMITTED CAME TO LESS THAN $3.5 MILLION; SO WE REMAIN CONFIDENT THAT OUR RESERVE IS MORE THAN ADEQUATE.

OUR OWN VOLUNTARY STEPS SINCE THE SETTLEMENT ARE LESS WELL KNOWN. SINCE THAT TIME, WE AT HUTTON HAVE TAKEN AGGRESSIVE NEW STEPS, ON OUR OWN, TO GUARD AGAINST WRONGDOING. THEY ARE DESCRIBED IN SOME DETAIL IN A LETTER WHICH I HAVE RECENTLY SENT TO CHAIRMAN HUGHES OF THE HOUSE SUBCOMMITTEE, WHICH I HAVE ALSO PROVIDED TO THE COMMITTEE, SO I WILL ONLY SUMMARIZE THEM BRIEFLY:

-- EVEN THOUGH THE JUSTICE DEPARTMENT DID NOT PROCEED AGAINST INDIVIDUALS, I RETAINED JUDGE GRIFFIN B. BELL, FORMER U.S. ATTORNEY GENERAL AND U.S. COURT OF APPEALS JUDGE, TO CONDUCT AN INDEPENDENT INVESTIGATION AND IDENTIFY THOSE RESPONSIBLE FOR THE ABUSIVE CONDUCT. HE RECOMMENDED THAT A NUMBER OF HUTTON MANAGEMENT PERSONNEL BE DISCIPLINED. WE HAVE DONE SO, AND IN SEVERAL INSTANCES HAVE GONE BEYOND WHAT JUDGE BELL SUGGESTED.

-- WE HAVE ALSO TIGHTENED UP DRAMATICALLY ON ALL OUR INTERNAL CASH MANAGEMENT PROCEDURES. ALL TREASURY RESPONSIBILITIES, INCLUDING CASH MANAGEMENT, ARE UNDER THE OVERALL DIRECTION OF OUR SENIOR VICE PRESIDENT FOR FINANCIAL OPERATIONS. OUR AUDITORS ARE INSTITUTING AUDIT PROCEDURES SPECIFICALLY DESIGNED TO PREVENT ANY TRANSACTIONS OR PRACTICES OF THE KINDS WHICH LED TO PAST ABUSES.

-- FINALLY, BECAUSE THE ABILITY OF A CORPORATION TO REFLECT HIGH STANDARDS IS VERY MUCH A FUNCTION OF THE QUALITY OF ITS MANAGEMENT TEAM, WE HAVE WORKED HARD TO RECRUIT EXCEPTIONAL PEOPLE TO HELP MANAGE THE COMPANY, PARTICULARLY IN THE SENSITIVE POSITIONS OF FINANCE AND LEGAL COMPLIANCE.

I AM ACCOMPANIED HERE TODAY BY THE PRESIDENT OF THE E.F. HUTTON GROUP, INC., ROBERT RITTEREISER, WHO JOINED US LAST JUNE. HE WAS FORMERLY CHIEF ADMINISTRATIVE OFFICER AND CHIEF FINANCIAL OFFICER AT MERRILL LYNCH. BOB RITTEREISER WAS NOT WITH THE FIRM WHEN THE CASH CONCENTRATION CASE AROSE OR WHEN THE SETTLEMENT WAS NEGOTIATED. HE HAS, HOWEVER, PLAYED A MAJOR ROLE IN THE REMEDIAL STEPS WE HAVE IMPLEMENTED, AND CAN DISCUSS THEM WITH YOU.

OUR NEW CHIEF FINANCIAL OFFICER IS EDWARD J. LILL, WHO WAS A PARTNER AND SPECIALIST IN THE FINANCIAL SERVICES INDUSTRY AT ONE OF THE "BIG EIGHT" ACCOUNTING FIRMS. OUR SENIOR VICE PRESIDENT OF FINANCIAL OPERATIONS, PAUL BEEHLER, WHO CAME FROM ANOTHER SUCH FIRM, IS RECOGNIZED AS ONE OF THE

NATION'S LEADING EXPERTS IN CORPORATE CASH MANAGEMENT. OUR NEW GENERAL COUNSEL AND EXECUTIVE VICE PRESIDENT FOR LAW AND POLICY, STEPHEN J. FRIEDMAN, IS A FORMER SEC COMMISSIONER WHO HAS PRACTICED SECURITIES LAW AT ONE OF THE LEADING NEW YORK FIRMS. FORMER MICHIGAN GOVERNOR WILLIAM G. MILLIKEN HAS RECENTLY JOINED OUR BOARD AS A NEW OUTSIDE DIRECTOR.

GIVEN THE MANY UNIQUE CIRCUMSTANCES OF OUR INDUSTRY AND THIS CASE, I THINK IT IS FAIR TO CONCLUDE THAT LAW ENFORCEMENT HAS WORKED HERE TO INSPIRE FAR-REACHING REFORM THAT WILL FORESTALL ANY RECURRENCE IN OUR COMPANY, AND PERHAPS MORE BROADLY IN THE INDUSTRY AS WELL.

OUR ENTIRE MANAGEMENT GROUP AT HUTTON SHARES A DETERMINATION THAT E.F. HUTTON WILL BE A GOOD CORPORATE CITIZEN. SINCE DISCOVERY OF THE MISTAKES THAT WERE MADE PRIOR TO 1982, E.F. HUTTON HAS RESPONDED PROPERLY AND CONSCIENTIOUSLY. WE HAVE MADE CERTAIN THEY WILL NEVER HAPPEN AGAIN. AND WE HAVE GONE FURTHER, TO ENSURE THAT WE WILL NOT ONLY MEET THE MINIMUM STANDARDS THE LAW REQUIRES, BUT THE HIGH ETHICAL STANDARDS WE FEEL OUR CLIENTS, THE PUBLIC, AND OUR EMPLOYEES DESERVE.

EFHutton
E F Hutton & Company Inc. One Battery Park Plaza, New York, N.Y. 10004 (212) 742-6728

Robert Fomon, Chairman
Chief Executive Officer

March 17, 1986

The Honorable William J. Hughes
341 Cannon House Office Building
Washington, D.C. 20515

Dear Chairman Hughes:

In the course of your Subcommittee's inquiry into Hutton's plea of guilty to mail and wire fraud in connection with abusive deviations from its cash concentration system, I have appeared as a witness on three occasions (June 19, 1985; July 19, 1985, and December 11, 1985). Many of the questions I have been asked have related to company actions taken to assure that improper practices will not recur. As I understand it, the Subcommittee's inquiry is nearing completion, and I therefore would like to take this opportunity to supplement my testimony on this point and bring events up-to-date. I would appreciate it if you would include this letter in the printed record of these proceedings.

Hutton's rehabilitation began as soon as senior management learned of abuses in the company's cash concentration system and long before the filing of the federal charges. These abuses came to the attention of Hutton's senior management over a several month period starting in late 1981. Even though management did not then believe that these problems were widespread or constituted illegal conduct, it recognized that they were improper and in contravention of established company policy and acted immediately to halt them. Accordingly, written instructions were issued to all branches prohibiting any deviations from the company's established drawdown procedures. The language used left no doubt that departures from the company's lawful drawdown system would not be tolerated.

The effectiveness of management's immediate remedial action is conclusively demonstrated by the fact - undisputed in the record before this Subcommittee or anywhere else - that all abusive practices stopped in early 1982.

However, Hutton did more than merely halt the improper practices in 1982. It modified its drawdown sheet and undertook an examination of the basic drawdown system with the assistance of Arthur Young & Company, an independent consulting firm with nationally recognized expertise in corporate cash management. Arthur Young confirmed that the new drawdown sheet was "an effective way of concentrating funds and a generally accepted approach." With the addition of some efficiency-enhancing modifications recommended by Arthur Young, Hutton implemented the new drawdown sheet in July 1982.

Since the plea agreement, Hutton has explained in detail its cash concentration system to its banks. Today, in excess of 300 banks accounts are operated in accordance with written agreements negotiated with each bank.

As required by the plea agreement, Hutton has instituted a massive restitution program. Through the restitution program, Hutton has insured that each and every bank harmed by improper drawdown activity will be fully repaid with interest. In the words of Stephen S. Trott, Assistant Attorney General in charge of the Criminal Division of the Justice Department, before this Subcommittee, this "is the most comprehensive program of restitution ever developed in a federal criminal case." In terms of curing the harm done by the improper banking practices, the restitution program offers a complete remedy.

On May 17, 1985, I announced a consolidation of treasury control responsibilities into the Control and Planning Division. Furthermore, I instructed Hutton's audit committee of outside directors to make recommendations to integrate control and treasury operations.

As a result of that review, Hutton has installed new financial controls with respect to the company's cash concentration activities. The new controls are both organizational and operational. As a matter of organization, Hutton has placed all treasury responsibilities -- including responsibility for cash management -- under the overall direction of Paul Beehler, one of the nation's leading experts in corporate cash management, and now Senior Vice President of Financial Operations. Among other things, Mr. Beehler developed a separate Treasury Control Group consisting of five individuals whose sole job is to manage and operate the treasury control system and the bank information system. This group deals directly with each of the company's 400 branch offices and has contact with most of them on a daily basis, monitoring the branches' banking transactions to insure that all banks are fairly compensated for services provided to Hutton.

At this time, branches have no say in what the target compensating balances are and cannot change the targets in the system without the express approval and action of the Treasury Control Group. Furthermore, all branch banks must be approved in New York.

On the operational side, Hutton is spending more than $30 million in new computerized systems (many of which were designed prior to the plea). One system, a new computerized drawdown procedure, will independently control and monitor the drawdown data entered at the branch office.

Another control is the introduction of Automated Clearinghouse (ACH) transfers within the cash concentration system. The use of ACH transfers to concentrate branch office cash receipts will insure that any delays in the clearing of funds will be minimized.

In addition, both our internal and outside auditors have been instructed to develop and institute special audit procedures designed to detect the future occurence of any transactions or practices which led to the past abuses. These procedures have been developed and special audit tests are being conducted on an ongoing basis.

Finally, Hutton has instituted a new procedure whereby New York customers automatically receive New York State checks. Hutton is studying the implementation of a system of regional disbursement banks (approximately 6 or 7) which would provide our customers around the country with checks drawn on the closest regional bank. If implemented, Hutton will be the first brokerage firm in the country to provide regional disbursement checks to customers.

Backing up the computer are new procedures whereby drawdown calculations are reviewed at both the branch and regional level, and by the Treasury Control Group in New York. Any discrepancies are followed up daily.

Hutton has taken a variety of steps to educate all of its employees concerning the practices and transactions which resulted in past abuses. Hutton has also instituted new procedures and policies to prevent future violations. On July 30, 1985, I circulated the "Statement of Corporate Procedures and Policies Regarding Cash Concentration" to all directors, officers, branch managers and account executives. This document described the practices to which Hutton pleaded guilty, and reiterated the company's policy to conduct its business in conformity with the law.

On July 26, 1985, Hutton's Director of Internal Audit circulated throughout the company a detailed explanation of the firm's revised drawdown procedures, including instructions regarding the particular responsibilities of each person involved in cash management activities. This document included line-by-line instructions for complying with the new drawdown procedures. Additional instructions further refining the drawdown procedure have subsequently been issued throughout the company.

A Legal and Compliance Bulletin entitled "Banking Relationships" was disseminated on October 18, 1985. This bulletin sets forth the company's policies and practices regarding the opening of bank accounts and the conduct of banking relationships.

Furthermore, Hutton conducted 21 live instructional seminars in 18 cities around the country to inform our employees about the nature of the illegal activities and the steps undertaken since the plea to prevent future deviations. These meetings, which included presentations by the company's outside legal counsel and independent auditors, were attended by more than 1,200 employees, officers, and board members around the country, all of whom signed affidavits attesting to their having reviewed the E.F. Hutton & Company Inc. Officer and Employee Information Package.

The company also has engaged the services of the Ethics Resource Center to assist it in developing a written code of ethics to provide guidance to all employees in the conduct of the company's business. These ethical guidelines, which include a means whereby an employee can report suspected wrongdoing to an independent body within Hutton outside of his or her chain of command, will become a standard part of training for all new account executives, assistant branch managers, branch managers, and managerial trainees.

In another very significant way, Hutton has taken steps beyond those required by the plea agreement. We were determined to find out what went wrong and who was responsible for the conduct that led to the plea and to take appropriate steps with regard to those employees.

I therefore retained Judge Griffin B. Bell, former Attorney General of the United States and Judge of the U.S. Court of Appeals for the Fifth Circuit, to conduct an independent investigation and report his findings and recommendations. The Bell Report recommended that a number of Hutton management personnel be disciplined for their roles in the banking improprieties.

Hutton has implemented those recommendations and, in several instances, has gone even further than Judge Bell suggested, even though none of the affected employees was found guilty of any intentional criminal conduct.

For example, Judge Bell recommended that Thomas Morley, who had been in charge of the cash desk at Hutton's New York headquarters, be transferred to another position. Hutton did more than that -- it obtained Mr. Morley's resignation from the company.

Judge Bell also recommended action against six branch managers. Hutton has obtained the resignation of one of these individuals, Perry Bacon, who was a First Vice President of the company. Judge Bell had not gone so far as to recommend Bacon's termination. Four other branch managers have relinquished their managerial posts, been fined $25,000 each, and have received official reprimands. In each instance Judge Bell recommended only a fine and the reprimand.

Four regional office employees also have been disciplined. One, Aaron Hickey, formerly of the South Central Region, has resigned. Two others -- Arthur Jensen of the Atlantic Region and Michael Goldstein of the Midwest Region -- have been suspended without pay for a month and reprimanded. A fourth, Ernest Dippel, who was regional sales manager in the Central Region, has been formally reprimanded as Judge Bell recommended.

Finally, the consequences of the guilty plea have reached into the highest ranks of Hutton's management. Thomas Lynch, formerly the company's de facto principal financial officer and vice chairman, has resigned from all corporate positions at the firm.

This is one of two major changes in the Company's senior management. The other is that Thomas Rae, the Company's General Counsel, is taking early retirement although not cited in the Bell Report as meriting sanctions. In addition, Richard Genin, formerly Senior Vice President for Regional Operations in Hutton's New York headquarters, has been issued a formal letter of reprimand.

These actions were undertaken by Hutton voluntarily in an affirmative demonstration of the company's commitment to remedy the abuses underlying the guilty plea. None of the affected employees was found guilty of any intentional criminal conduct.

On a broader level, Hutton has committed itself to far-reaching changes in its basic structure of corporate governance. Consistent with Judge Bell's recommendation, a majority of the directors of Hutton Group, Hutton's corporate parent, will be outside directors rather than officers or employees. This change will take place with the board elections scheduled for the next regular shareholders' meeting in May. Former governor of Michigan, William G. Milliken, has recently joined the Board as a new outside director.

The company is also complying with Judge Bell's recommendation that a separate audit committee for E.F. Hutton and Company Inc. be established, in addition to the audit committee of Hutton Group. The Hutton audit committee will have oversight over the company's internal financial auditors and its regulatory auditors, and its work will be subject to review by the Hutton Group audit committee.

Finally, two recent personnel announcements have strengthened our financial and regulatory management team. Edward J. Lill, formerly a partner with 33 years of service at Deloitte Haskins & Sells, was recently appointed Chief Financial Officer. Mr. Lill was partner-in-charge of the financial services industry practices at DH&S. Steven J. Friedman, former SEC commissioner and senior partner at Debevoise and Plimpton with responsibilities for its securities practice, has also joined Hutton as General Counsel and Executive Vice President for Law & Policy.

Hutton has devoted enormous resources to these internal reforms and to full cooperation with this Subcommittee. We have done this to assure that all abuses came to light and that they never recur. I appreciate this opportunity to complete the record on this important subject.

Best regards,

Robert Fomon

Robert Fomon
Chairman and Chief Executive Officer

cc: The Honorable William McCollum

enclosures:

"Statement of Corporate Procedures & Policies Regarding Cash Concentration" (July 30)

Banking Relationships (October 18)

Legal and Compliance Bulletin E

TO: All Officers and Branch Managers

FROM: Law Department

DATE: October 18, 1985

SUBJECT: Banking Relationships

Set forth below are Hutton's new policies and procedures relating to the continuance of existing banking relationships as well as the commencement of new relationships.

These policies reflect obligations imposed upon Hutton by the Final Judgment of Permanent Injunction entered in United States v. The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. Civil No. 85-0601 (Middle District of Pennsylvania), a copy of which is attached as Exhibit A.

I. Existing Bank Relationships: In general, all bank accounts must be operated in accordance with the detailed operating procedures in effect from time to time. Current policy is set forth in Legal and Compliance Bulletin 30.

A. All banks with which we currently do business have received a memorandum explaining our current cash concentration system. It is the responsibility of the Financial Operations Division and the Law Department to modify and update this memorandum as required. Copies of the memorandum may be obtained from the Treasury Control Department of the Financial Operations Division. The Financial Operations Division is solely responsible for bank selection and compensation.

B. Each bank has been asked to execute a Standard Bank Consent Form that explicitly authorizes Hutton to draw on uncollected funds. Certain banks have been approached locally, while others have been contacted on a national level. Copies of the Standard Bank Consent Forms may be obtained from the Treasury Control Department of the Financial Operations Division.

C. All requests for modification of the Standard Bank Consent Form must be approved by the Treasury Control Department and the Law Department. An organizational chart showing the structure of the reorganized Financial Operations Division will be issued shortly. All signed consents or bank contacts regarding such consents, including requests for modification, are to be forwarded immediately to the Treasury Control Department in New York.

D. Until such time as the bank has executed an acceptable consent, the branch must continue to drawdown in accordance with the system set forth in Hutton Form 3478C attached hereto as Exhibit B. Upon receipt of an acceptable executed consent, the branch will be authorized by wire from the Treasury Control Department when it may begin using the new drawdown worksheets. It is against company policy for any branch to deviate from the drawdown procedure set forth in Exhibit D without the prior written approval of the Treasury Control Department. Under no circumstances are any modifications or alterations to be made to the drawdown procedures at the branch or regional level. All modifications, changes or alterations must have the prior written approval of the Treasury Control Department and the Legal Department.

E. Under no circumstances may billings for bank service charges of any nature in excess of $75.00 per month or billings for account analysis losses (regardless of amount) be paid locally. All such billings must be forwarded to the Treasury Control Department, to be processed for payment. For payments of $75.00 or less, a copy of all charges, the payment check and a brief but specific explanation should be forwarded to the Treasury Control Department.

F. It is against company policy to change compensation levels for banks at the branch or regional level. All changes in the compensation level must be authorized in writing by the Treasury Control Department.

II. New Bank Relationships

Below are the policies that are to be observed when a new banking relationship is commenced. The following situations are covered by this section:

a. A new branch or satellite opens and needs to open its bank account;

b. A branch or satellite desires to change its bank or add an additional bank;

c. A new regional bank account is sought;

d. A regional bank account is to be changed; or

e. A new bank account for The E.F. Hutton Group Inc. or one of its subsidiaries is to be opened or an existing bank account is to be moved to another institution.

A. Any new bank account (changes or additions) must have the prior written approval of the Treasury Control Department before it can be opened.

1. The office opening such an account must notify their Regional Operations Manager (ROM) and the Treasury Control Department of their desire to begin or change a Bank Relationship and supply the following documents and/or information to the ROM who will forward same to the Treasury Control Department:

   a) Sample account analysis illustrating how balances are applied, the Federal Reserve Requirement and earnings calculations, typical service costs and the profit/loss position at month end;

   b) The bank's availability schedule (or documentation of availability of deposits), including stated cut-off times to qualify for the availability schedules;

   c) Written information concerning all fees, service charges and compensating balance criteria including:

      -calculation formula for fee and balance compensation;

      -availability of and fees for special services on account;

   d) The most recent financial statements of the bank;

   e) A list of other cash management services available from the bank;

   f) Signature cards;

   g) A statement from the bank indicating that it is a receiving Automated Clearing House (ACH) participant; and

h) A copy of the check specifications.

2. The bank must be willing to do the following:

a) Sign our bank consent form;

b) Provide monthly account analysis to both the Treasury Control Department and the branch;

c) Evaluate the profit/loss position in the account on a quarterly, semi-annual, or annual basis; and

d) Sign Hutton's Return Check Agreement (Form 3662) attached hereto as Exhibit C.

3. The office opening such an account should also determine the following:

a) The bank's cut-off hour for daily deposits (of unencoded items) to receive same day ledger credit or to qualify for the availability schedule;

b) The bank's daily balance reporting procedures, including:

-the methods available for reporting such information; and

-the type of information available (i.e., ledger, collected balances).

c) The bank's procedures to:

-handle "stop payment" requests;

-process daily deposits;

-handle return items;

-handle ACH/DTC transactions for amounts greater than collected balances;

-immediately advise Hutton via telephone of NSF debits; and

-handle discrepancies between the bank's records and those of Hutton.

4. The Treasury Control Department must be satisfied that:

a) the bank's services are competitively priced in relation to those of other banks in the same locale and that those services are of acceptable quality;

b) the bank will abide by its fee and compensation schedule for a stated period; and

c) the bank can adequately handle the average operating volume of the branch in question.

B. All new banks with which Hutton will do business must be provided with a copy of the cash concentration memorandum described in Section I (A) of this bulletin and the procedures set forth in items 1, B through D, inclusive, must also be followed with respect to new banking relationships.

C. Upon initial approval of any change of banking relationships or the creation of any new relationship, the Treasury Control Department will obtain from the Accounting Department a general ledger account number for such account. The Treasury Control Department will then forward executed signature cards and corporate resolution to the branch with a copy to the ROM. Upon receipt, the branch manager should obtain from the bank, the signed bank consent along with written confirmation of the profit/loss evaluation agreement. Originals of all three must be forwarded to the Treasury Control Department and copies should be retained at the branch and regional offices. The Treasury Control Department will then wire the branch and the ROM with final authorization to begin doing business with the bank in question and will supply the appropriate branch and Regional personnel with the necessary general ledger account information.

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

THE E.F. HUTTON GROUP INC.,
E.F. HUTTON & COMPANY INC.,

Defendants

EXHIBIT "A"

CIVIL NO. 85-0601

FINAL JUDGMENT OF PERMANENT
INJUNCTION AGAINST
THE E.F. HUTTON GROUP INC. AND
E.F. HUTTON & COMPANY INC.

Plaintiff, the United States of America, having duly commenced this action by filing its Complaint for Permanent Injunction and Ancillary Relief ("Complaint") and defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. ("Hutton Group" and "Hutton Company") having appeared and admitted to the jurisdiction of this Court over them and over the subject matter of this action, having waived the making of any findings of fact or conclusions of law, before the taking of any testimony and without trial, argument or adjudication of any issue of fact or law herein; admitting the allegations of the Complaint; having consented to the entry of this Final Judgment of Permanent Injunction, and having entered into certain undertakings contained in the Consent and Undertaking of The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. annexed hereto and incorporated herein, it is hereby

I

ORDERED, ADJUDGED AND DECREED that The E.F. Hutton Group Inc., E.F. Hutton & Company Inc., their directors, officers, agents, employees, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and those persons in active concert or participation with them, and each of them, are hereby permanently restrained and enjoined from:

(1) violating Section 1341 of Title 18 of the United States Code by, directly or indirectly, knowingly devising or intending to devise any scheme or artifice to defraud, for the purpose of obtaining money or property, for the benefit of Hutton Group or Hutton Company, by means of false or fraudulent pretenses, representations, or promises, and, for the purpose of executing such scheme or artifice or attempting so to do, placing in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or taking or receiving therefrom, any such matter or thing, or knowingly causing to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing; and

(2) violating Section 1343 of Title 18 of the United States Code by, directly or indirectly, knowingly devising or intending to devise any scheme or artifice to defraud, or for the purpose of obtaining money or property for the benefit of Hutton Group or Hutton Company, by means of false or fraudulent pretenses, representations, or promises, transmitting or causing to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice; and

(3) violating Section 1344 of Title 18 of the United States Code by, directly or indirectly, knowingly executing or attempting to execute a scheme or artifice:

(a) to defraud any federally chartered or insured financial institution; or

(b) to obtain, for Hutton Group or Hutton Company, any of the moneys, funds, credits, assets, securities or other property owned by or under the custody or control of a federally chartered or insured financial institution by means of false or fraudulent pretenses, representations, or promises.

II

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that The E.F. Hutton Group Inc., E.F. Hutton & Company Inc., their directors, officers, agents, employees, directors, successors, assigns and all operating affiliates and subsidiaries actually controlled by them, and those persons in active concert or participation with them, and each of them, are hereby permanently restrained and enjoined from:

(1) failing to disclose and describe, in writing, to each bank or financial institution with which they maintain a depository account, all money management practices or techniques which may affect, directly or indirectly, the use of such account in connection with the concentration of funds, including, without limitation, intra-company transfers of funds into and out of such account, and

(2) drawing down, from any Hutton account at a depository bank, arbitrary amounts by means of overdraft checks unrelated to the volume of customer funds deposited, and thereafter covering such drawdowns by checks drawn upon another of Hutton's accounts and

(3) causing funds to be successively transferred between defendants' various branch and regional bank accounts, prior to their deposit in a prime depository bank, in order to inflate the funds drawn down so that they exceed the amount of customer funds originally deposited; and (i) utilizing in conjunction therewith formulas and methods by which the actual amount of customer funds are excessively multiplied or otherwise arbitrarily increased and (ii) thereby exploiting the opportunities for delayed clearing times of items deposited into the defendants' branch depository banks, and

(4) causing uncollected funds to be withdrawn by any means, including the use of a multiplier or formula, from Hutton accounts in depository banks at which Hutton maintains a deposit relationship unless there are written agreements or consents of the banks authorizing such withdrawals, and

(5) withdrawing, by any means including the use of a multiplier or formula, from Hutton's accounts at depository banks funds in excess of funds actually received from customer or institutional clients in the ordinary course of business, unless there are written agreements or consents of the banks authorizing such withdrawals, and

(6) creating float by retarding, delaying or obstructing the clearing of checks deposited in the defendants' branch or regional depository banks other than by way of stop orders, directions not to pay or other credit related techniques, and

(7) simultaneously drafting and issuing Hutton checks, in identical amounts drawn on different banks, and cross-depositing each said check in the other bank, thereby causing each bank to certify next day opening balances in their account

The prohibitions described in paragraphs "(2)" through "(7)" above shall take effect with the entry of this injunction, the prohibition described in paragraph "(1)" above shall take effect ninety (90) days after the date of this injunction

III

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the annexed Consent and Undertaking of The E.F. Hutton Group, Inc. and E.F. Hutton & Company Inc. be, and the same hereby is, incorporated herein with the same force and effect as if fully set forth herein.

IV

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. shall fully comply with their undertakings as set forth in the attached Consent and Undertaking of The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc.

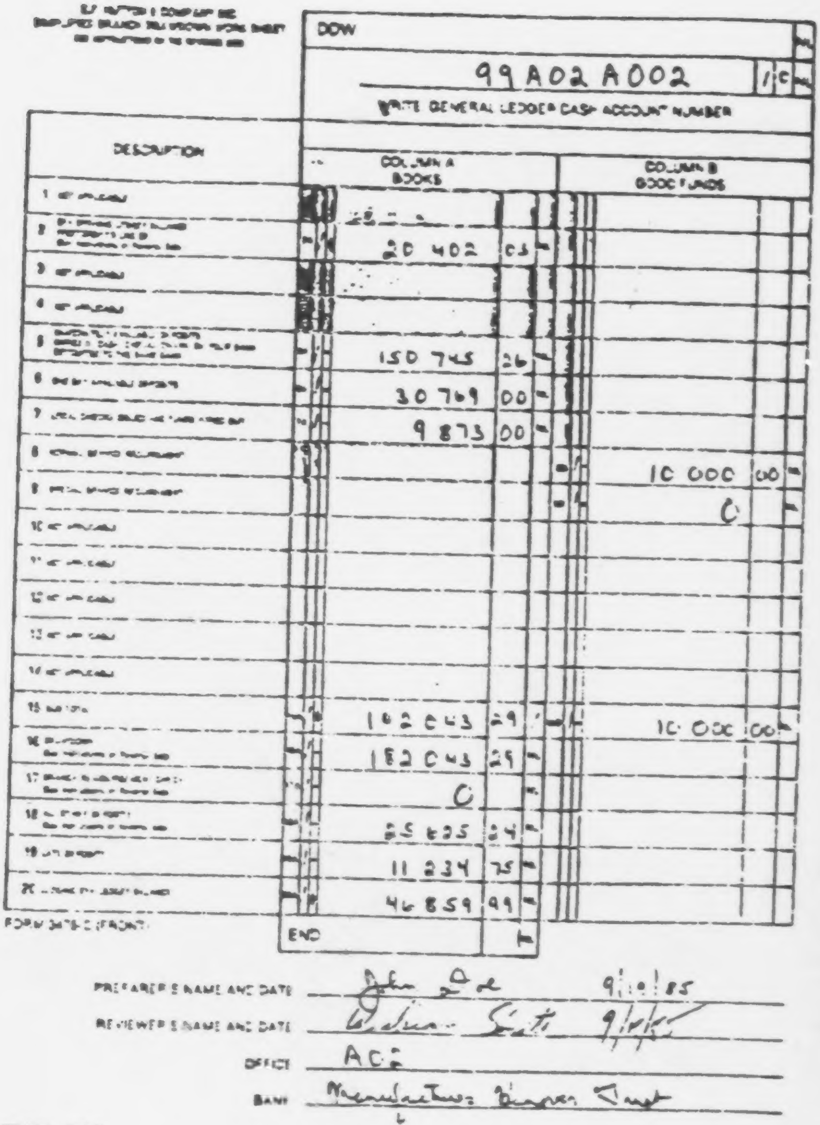
V

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that this Court shall retain jurisdiction of this matter for all purposes

/s/ WILLIAM J. NEALON

UNITED STATES DISTRICT JUDGE

DATED May 2, 1985
Scranton, Pennsylvania



DDW

99A02A002 / C

WRITE GENERAL LEDGER CASH ACCOUNT NUMBER

DESCRIPTION	COLUMN A BOOKS		COLUMN B GOOD FUNDS	
1				
2	20 402	03		
3				
4				
5	150 745	26		
6	30 769	00		
7	9 873	00		
8			10 000	00
9			0	
10				
11				
12				
13				
14				
15	192 043	29	10 000	00
16	182 043	29		
17	0			
18	25 625	24		
19	11 234	75		
20	46 859	99		
END				

PREPARER'S NAME AND DATE John Doe 9|10|85

REVIEWER'S NAME AND DATE

OFFICE AC

BANK Manufacturers Hanover Trust

EXHIBIT "B"

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DDW
99A02A002/C
2A/+2040203
5A/+15074526
6A/+3076900
7A/-987300
8B/-1000000
9B/-0
15A/+19204329/15B/-1000000
16A/-18204329
17A/+0
18A/+2562524
19A/+1123475
20A/+4685999
END
```

1. **NOT APPLICABLE.**

2. **EFH OPENING LEDGER BALANCE.**
ENTER YESTERDAY'S LINE 20 (CLOSING GENERAL LEDGER BALANCE) IN COLUMN A AS FOLLOWS:

   IF YESTERDAY'S LINE 20 WAS POSITIVE ENTER THE NUMBER AS AN ADDITION TO COLUMN A
   EXAMPLE: IF PREVIOUS DAY'S LINE 20 WAS + 20,000 00, TODAY'S LINE 2 WOULD BE
   COL A + 20,000 00
   IF LINE 20 WAS NEGATIVE, CONTACT YOUR REGIONAL CASHIER IMMEDIATELY FOR INSTRUCTIONS

3. **NOT APPLICABLE.**

4. **NOT APPLICABLE.**

5. **IMMEDIATELY AVAILABLE DEPOSITS.**
TOTAL ALL THE CHECKS DRAWN ON YOUR BANK DEPOSITED INTO THE SAME BANK, CASH DEPOSITED INTO YOUR BANK, AND MONEY WIRED INTO YOUR BANK. ENTER IN COLUMN A. A SEPARATE BLOTTER AND DEPOSIT SLIP SHOULD BE PREPARED FOR CHECKS AND CASH IN THIS CATEGORY. THIS NUMBER WILL ALWAYS BE ADDED WHEN CALCULATING COLUMN A TOTALS.

6. **ONE DAY AVAILABLE DEPOSITS.**
YOUR REGIONAL CASHIER WILL INSTRUCT YOU IN DETERMINING THOSE CHECKS THAT ARE ONE DAY AVAILABLE DEPOSITS. ENTER THE TOTAL OF THESE ONE DAY DEPOSITS IN COLUMN A. A SEPARATE BLOTTER AND DEPOSIT SLIP SHOULD BE PREPARED FOR CHECKS IN THIS CATEGORY. THIS DEPOSIT TOTAL WILL ALWAYS BE ADDED WHEN CALCULATING COLUMN A TOTALS.

7. **LOCAL CHECKS ISSUED & FUNDS WIRED OUT.**
TOTAL ALL THE CHECKS ISSUED BY YOU ON YOUR LOCAL BANK, FUNDS WIRED OUT OF YOUR LOCAL ACCOUNT, RETURNED CHECKS AND MISCELLANEOUS BANK CHARGES WHICH WERE DISCOVERED TODAY. ENTER IN COLUMN A. THIS NUMBER WILL ALWAYS BE SUBTRACTED WHEN CALCULATING COLUMN A TOTALS.

8. **NORMAL SERVICE REQUIREMENT.**
ENTER $10,000 UNLESS INSTRUCTED DIFFERENTLY BY YOUR REGIONAL CASHIER. THIS NUMBER WILL ALWAYS BE SUBTRACTED WHEN CALCULATING COLUMN B TOTALS.

9. **SPECIAL SERVICE REQUIREMENT.**
ALWAYS ENTER 0 UNLESS INSTRUCTED DIFFERENTLY BY YOUR REGIONAL CASHIER.

10. **NOT APPLICABLE.**

11. **NOT APPLICABLE.**

12. **NOT APPLICABLE.**

13. **NOT APPLICABLE.**

14. **NOT APPLICABLE.**

15. **SUB TOTAL.**
COLUMN A TOTAL LINES 2, 5, 6 AND 7.
COLUMN B TOTAL LINES 8 AND 9.

16, 17. **DRAWDOWN AND/OR BRANCH REIMBURSEMENT CHECK.**
TO DETERMINE WHAT IS TO BE DRAWNDOWN AND/OR IF A BRANCH REIMBURSEMENT CHECK IS NEEDED, FOLLOW THE INSTRUCTIONS BELOW.

IF LINE 15 COLUMNS A&B ARE BOTH PLUS, DRAWDOWN THE TOTAL AND ENTER ON LINE 16. ENTER ZERO ON LINE 17.
IF LINE 15 COLUMNS A&B ARE BOTH MINUS, ISSUE A BRANCH REIMBURSEMENT CHECK FOR THE TOTAL AND ENTER ON LINE 17. ENTER ZERO ON LINE 16.
IF LINE 15 COLUMN A IS PLUS AND COLUMN B IS MINUS, THEN NET THE TWO AND
   IF THE SUM IS PLUS, DRAWDOWN THE NET AND ENTER ON LINE 16 AND ENTER ZERO ON LINE 17 OR
   IF THE SUM IS MINUS, ISSUE A BRANCH REIMBURSEMENT CHECK FOR THE NET AND ENTER ON LINE 17, AND ENTER ZERO ON LINE 16.
IF LINE 15 COLUMN A IS MINUS AND COLUMN B IS PLUS, ISSUE A BRANCH REIMBURSEMENT CHECK FOR THE AMOUNT OF COLUMN A AND ENTER ON LINE 17, AND THEN DRAWDOWN THE AMOUNT OF COLUMN B AND ENTER ON LINE 16.

18. **ALL OTHER DEPOSITS.**
YOUR REGIONAL CASHIER WILL INSTRUCT YOU IN DETERMINING THOSE CHECKS THAT ARE OTHER THAN IMMEDIATELY AVAILABLE OR ONE DAY AVAILABLE. THE TOTAL OF THESE DEPOSITS SHOULD BE ENTERED IN COLUMN A. A SEPARATE BLOTTER AND DEPOSIT SLIP SHOULD BE PREPARED FOR CHECKS IN THIS CATEGORY. THIS DEPOSIT TOTAL WILL ALWAYS BE ADDED WHEN CALCULATING COLUMN A TOTALS.

19. **LATE DEPOSITS.**
ALL CHECKS DEPOSITED AT THE BANK TODAY AND ENTERED INTO "THE CASH OVER THE WIRE SYSTEM", BUT NOT INCLUDED IN TODAY'S DRAWDOWN SHOULD BE ENTERED HERE. PLEASE INSURE THAT THE DEPOSIT IS MADE BEFORE THE LOCAL BANK CUT OFF TIME SO LEDGER CREDIT IS RECEIVED FOR OUR DEPOSIT. A SEPARATE BLOTTER AND DEPOSIT SLIP SHOULD BE PREPARED FOR ITEMS IN THIS CATEGORY. THIS NUMBER WILL ALWAYS BE ADDED WHEN CALCULATING COLUMN A TOTALS.

20. **CLOSING EFH GENERAL LEDGER BALANCE.**
TOTAL COLUMN A LINES 15 THRU 19 AND ENTER ON LINE 20.

YOU MUST NOW INFORM YOUR REGIONAL CASHIER OF THE DRAWDOWN AMOUNT ON LINE 16 AND WIRE THE COMPLETE DRAWDOWN WORKSHEET BY LINE ITEM USING THE AUTHORIZED WIRE FORMAT TO THE REGIONAL CASHIER AND TO THE TREASURY OPERATIONS DEPARTMENT.

IMPORTANT: AT THE CLOSE OF BUSINESS ON FRIDAY (OR THE LAST DAY OF THE WORK WEEK), YOU MUST SEND A COPY OF THE WORKSHEET TO YOUR REGIONAL CASHIER.

: IN WEEKS WITH HOLIDAYS YOU WILL RECEIVE SUPPLEMENTAL INSTRUCTIONS FROM YOUR REGIONAL CASHIER.

EFHutton

Agreement between E. F. Hutton & Company Inc. (Hutton) and the

____ (Bank).

In consideration of Hutton maintaining an account with the Bank and the mutual agreements contained herein, Hutton and the Bank agree as follows:

1) The Bank agrees that it will immediately notify Hutton of all checks or drafts which are rejected for deposit for any reason. Said notice will be given telephonically to the manager or cashier of the Hutton office maintaining the subject account. If such checks or drafts are rejected by a clearing correspondent of the Bank, notice will be given no later than the next banking day following the day the Bank receives notices of such rejection from its clearing correspondent(s).

2) Hutton agrees that it will promptly deposit with the Bank an amount equal to the checks or drafts which are rejected, provided that said checks or drafts are properly rejected by the Bank or its clearing correspondent(s) within statutorily prescribed time limits and notice is received by Hutton in accordance with this Agreement.

3) The Bank agrees that it will not charge back any account of Hutton's for the amount of checks or drafts which are rejected, provided that Hutton deposits an amount equal to the aforesaid rejected deposits within the same day of Hutton's receipt of notice in accordance with this Agreement.

E. F. Hutton & Company Inc.

Accepted by:

______________________ ______________
signature date

____
(print name)

____
(title)

JAMES A. TRACARICO, JR.
SR. VICE PRESIDENT
LEGAL
1 BROADWAY

EFHutton

LEGAL & COMPLIANCE BULLETIN #30

To: All Directors, Officers, Branch Office Managers and Account Executives

From: Robert M. Fomon

Date: July 30th, 1985

Subject: Statement of Corporate Procedures and Policies Regarding Cash Concentration

On September 26th, 1978, The E. F. Hutton Group Inc. issued a policy statement entitled "Policy Statement as to Standards of Business Conduct". This Policy Statement is reiterated in Legal & Compliance Bulletin #21 dated April 1st, 1982 and states in part that "It is the policy of The E. F. Hutton Group Inc. and its domestic and foreign subsidiaries ("The Company") to conduct Company business in accordance with the applicable laws and regulations of the United States and all other countries in which the Company operates and to refrain from unethical business practices".

On May 2nd, 1985, E. F. Hutton & Company Inc. entered a plea of guilty in the United States District Court for the Middle District of Pennsylvania to charges of mail and wire fraud arising from its business relationships with certain commercial banks. As part of the Plea Agreement and the Consent and Undertaking in the attendant civil injunctive proceeding, the Company has agreed to prohibit in writing the practices and transactions which formed the basis for the entry of the guilty plea in this matter.

In order to ensure completeness and exactness the full text of the Criminal Information, the Complaint for Permanent Injunction and Ancillary Relief and the Final Judgment of Permanent Injunction are attached hereto and made a part of this Statement. These documents describe the practices and transactions which are prohibited by our Corporate policy and by law.

As stated previously it has and continues to be the policy of the Company to prohibit illegal activity of any nature. Without limiting the generality of the foregoing, it is now specifically stated as Corporate procedure and policy that all directors, officers, employees and agents of E. F. Hutton & Company Inc. are expressly forbidden to engage in any of the prohibited practices and transactions that are described in the Criminal Information, the Complaint for Permanent Injunction and Ancillary Relief and the Final Judgment of Permanent Injunction attached hereto.

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA.
v.
E.F. HUTTON & COMPANY INC.

CRIMINAL NO. 85-00083
INFORMATION

The United States Attorney for the Middle District of Pennsylvania charges that:

INTRODUCTION

1. At all times material to this information, the defendant E.F. Hutton & Company Inc. ("Hutton Company"), a Delaware corporation and a wholly owned subsidiary of The E.F. Hutton Group Inc., maintained its principal offices at One Battery Park Plaza, New York, New York. The defendant Hutton Company is one of the nation's largest broker-dealers of securities and is registered with the Securities and Exchange Commission pursuant to Section 15 of the Securities Exchange Act of 1934 [15 U.S.C. §78o]. The defendant's parent company, The E.F. Hutton Group Inc., is a publicly held corporation and its stock is registered with the Securities and Exchange Commission pursuant to Section 12 of the Securities Exchange Act of 1934 [15 U.S.C. §78l].

2. At all times material to this information, the defendant Hutton Company was organized into nine domestic and one international operating regions. These regions were:

Northeast Region in Boston, Massachusetts
Atlantic Region in New York, New York
Southeast Region in Atlanta, Georgia
Midwest Region in Chicago, Illinois
Central Region in Kansas City, Missouri
South Central Region in Houston, Texas
Mountain Region in Denver, Colorado
Pacific North Region in San Francisco, California
Pacific South Region in Los Angeles, California
International Region in Geneva, Switzerland

Each of these regions was supervised by a regional vice-president who reported directly to the defendant firm's president. In each of its domestic operating regions, the defendant Hutton Company maintained branch offices supervised by branch office managers. Regional and branch offices of the defendant Hutton Company also employed operations managers and cashiers who performed "back office" functions of the defendant's business. These regional and branch office operations managers and cashiers reported directly to their immediate supervisors, the regional vice-presidents and the branch office managers, and indirectly to the defendant Hutton Company's operations managers in New York City.

3. At all times materials to this information, the defendant Hutton Company received from its individual and institutional customers, in the course of its business, between $40 million and $200 million each business day at its more than 300 branch offices located throughout the United States. Funds received from said customers were ordinarily first deposited in various local despository accounts maintained by the defendant Hutton Company in approximately 400 banks and financial institutions located throughout the United States.

4. As used herein, the terms "despository bank" and "depository account" shall mean the bank or account to which any instrument for the payment of money is transferred for collection. In many cases, as more fully set forth below, the defendant Hutton Company's stated purpose in having its branches open such accounts at depository banks was to use these accounts for the collection and concentration of funds received from its customers, and it was the expectation of these depository banks that such accounts would be so used.

5. At all times material to this information, defendent Hutton Company instituted and maintained a domestic "cash concentration" system, the legititmate purpose of which was to collect funds received from the defendant Hutton Company's individual and institutional customers, to transfer those funds to regional depository bank accounts and thereafter to transfer those deposits to certain prime depository bank accounts maintained in New York City and Los Angeles, California.

6. In general terms, this system, which was also known as the "drawdown system", operated as

(a) branch office cashiers of the defendant Hutton Company were instructed to calculate, on a daily basis, the net activity in their branch office's depository bank accounts and to transmit that information to their regional office cashiers. The regional offices maintained checks for each of the branch office depository accounts located in their regions, and the defendant Hutton Company's regional office personnel would thereafter prepare "depository transfer checks", or "DTC's", drawn upon each branch office depository account, and deposit these DTC's into the appropriate regional office depository bank accounts.

(b) following the process described in sub-paragraph "6(a)" above, the regional offices of the defendant Hutton Company would telephone the defendant's "Cash Desk" in New York City and report the aggregate net activity in the various regional depository bank accounts (which net activity included, as its primary component, the DTC's described above). Promptly thereafter, the Cash Desk would prepare DTC's drawn upon the regional depository bank accounts of the defendant Hutton Company's South Central, Southeast, Northeast and Atlantic regions and manually deposit those items into an account maintained at Manufacturers Hanover Trust Company, the defendant's prime concentration bank in New York City. Information as to the amount of funds deposited into the defendant Hutton Company's regional depository bank accounts for its Pacific North, Pacific South, Mountain, Central and Midwest regions was telexed by the Cash Desk in New York City to Bank of America, the defendant's prime concentration bank in Los Angeles, California. Bank of America, acting as agent for the defendant Hutton Company, immediately prepared DTC's drawn upon the aforesaid regional depository accounts for collection into the defendant's concentration account.

(c) at various times material herein, the defendant Hutton Company maintained "zero balance" accounts at United States Trust Company of New York and Chemical Bank in New York City and Bank of America in Los Angeles. By arrangement with these banks, the defendant Hutton Company was permitted to draw checks upon these accounts — in which the defendant Hutton Company was required to keep no balance — with the understanding that the defendant would, on a daily basis, wire transfer into these accounts sufficient funds to cover all checks presented against the accounts for payment.

COUNTS 1-100

SCHEME TO DEFRAUD

7. Beginning on or about July 1, 1980 and continuing through February 28, 1982, in the Middle District of Pennsylvania and elsewhere, the defendant Hutton Company devised and intended to devise a scheme and artifice to defraud and obtain money from various banks and financial institutions with which the defendant Hutton Company had established depository relationships, as more fully set forth below.

OBJECT OF THE SCHEME

8. The object of the defendant's scheme and artifice to defraud was to obtain interest free funds by means of intentional overdrafting of various of its depository bank accounts, in the manner and means more fully described herein.

MANNER AND MEANS OF EFFECTING THE SCHEME AND ARTIFICE TO DEFRAUD

9. It was part of said scheme and artifice to defraud that the defendant Hutton Company would fraudulently misuse its depository bank accounts, for the purpose of obtaining the interest-free use of bank funds, by the following activities, including manipulating the check collection system and procedures of the Federal Reserve System and causing repeated and substantial drawings against uncollected funds:

(a) drawing down arbitrary amounts, unrelated to, and in excess of, the volume of customer funds deposited, and thereafter covering such excessive drawdowns by depositing checks drawn upon zero balance accounts of the defendant Hutton Company; and

(b) causing funds to be successively transferred between various branch and regional depository bank accounts of the defendant Hutton Company, prior to their deposit in a prime depository bank, [illegible] originally deposited; and (i) utilizing in conjunction therewith formulas and methods by which the actual amount of customer funds was excessively multiplied or otherwise arbitrarily increased and (ii) exploiting the opportunities for delaying clearing times of items deposited into the defendant's branch and regional depository banks

During the period from July 1, 1980 through February 28, 1982, the defendant Hutton Company's drawings against uncollected funds aggregated well in excess of $1 billion.

10. It was a further part of said scheme and artifice to defraud that the following manner and means were utilized to further the fradulent misuse of the defendant Hutton Company's depository bank accounts described in paragraph "9." above:

(a) the draft, issue and negotiation of checks drawn upon certain of the defendant Hutton Company's branch and regional depository accounts in arbitrary amounts unrelated to and in excess of the amounts shown upon the defendant's book balances for said accounts at the time of said draft, issue and negotiations; and

(b) covering the checks described in sub-paragraph "(a)" above by drafting checks upon zero balance accounts, and depositing said checks into the defendant Hutton Company's branch and regional depository banks for the purpose of concealing the arbitrary and excessive amount of overdrafts in said depository accounts; and

(c) causing uncollected funds to be withdrawn from certain of the defendant Hutton Company's branch and regional depository banks to such an extent as to produce a net ongoing uncollected balance at those banks without the prior agreement or consent of those banks authorizing said withdrawals.

11. Between July 1, 1980 and February 28, 1982, in the Middle District of Pennsylvania and elsewhere, the defendant Hutton Company, for the purpose of executing the scheme and artifice to defraud, and attempting to do so, did knowingly cause to be delivered by the United States Postal Service, according to the directions thereon, certain mail matter on 100 occasions.

All in violation of Title 18, United States Code, Section 1341.

COUNTS 101-2,000

12. Paragraphs "1." through "10." of Counts 1-100 of this information are hereby realleged and incorporated by reference as though fully set forth herein.

13. Between July 1, 1980 and February 28, 1982, in the Middle District of Pennsylvania and elsewhere, the defendant Hutton Company, for the purpose of executing the scheme and artifice to defraud, and attempting to do so, did knowingly transmit and cause to be transmitted by means of wire communications in interstate commerce, writings, signs, signals, pictures and sounds on 1,000 occasions.

All in violation of Title 18, United States Code, Section 1343.

/s/ JAMES J. WEST

JAMES J. WEST
United States Attorney

/s/ ROBERT W. OGREN

ROBERT W. OGREN
Chief, Fraud Section
Criminal Division
U.S. Department of Justice

/s/ ALBERT R. MURRAY, JR.

ALBERT R. MURRAY, JR.
Assistant United States Attorney

/s/ PETER B. CLARK

PETER B. CLARK
Trial Attorney
U.S. Department of Justice

IN THE UNITED STATES DISTRICT COURT
[illegible]

UNITED STATES OF AMERICA,

Plaintiff,

v

THE E F HUTTON GROUP INC ,
E F HUTTON & COMPANY INC ,

Defendants

CIVIL ACTION NO 85-0601

COMPLAINT FOR PERMANENT
INJUNCTION AND ANCILLARY
RELIEF

Plaintiff, the United States of America, for its complaint herein alleges as follows

1 Defendants are The E F Hutton Group Inc ("Hutton Group") and E F Hutton & Company Inc ("Hutton Company") Hutton Company was in the past engaged in acts and practices which constitute violations of Sections 1341 and 1343 of Title 18 of the United States Code, and defendants may be or are about to engage in practices which constitute violations of Section 1344 of Title 18 of the United States Code

2 The plaintiff brings this action to enjoin such acts and practices pursuant to Section 1345 of Title 18 of the United States Code

3 The Court has jurisdiction of this action pursuant to Section 1345 of Title 18 of the United States Code

4 The defendants could and/or are about to, unless restrained and enjoined, engage in the acts and practices set forth in this Complaint and in acts and practices of similar purport and object

5 The acts and practices constituting the violations herein have occurred and may occur within the jurisdiction of the United States District Court for the Middle District of Pennsylvania and elsewhere.

6 The defendants, directly and indirectly, made use of the United States mail, wire communications and facilities and instrumentalities of interstate transportation and commerce in connection with the acts and practices alleged herein, in the Middle District of Pennsylvania and elsewhere.

THE DEFENDANTS

7 Defendant The E.F. Hutton Group Inc. ("Hutton Group"), a Delaware corporation, maintains its principal offices at One Battery Park Plaza, New York, New York. Hutton Group is a publicly held corporation, and its stock is registered with the Securities and Exchange Commission pursuant to Section 12 of the Securities Exchange Act of 1934 [15 U.S.C. §78l]. Hutton Group is the parent of the defendant E.F. Hutton & Company Inc.

8 Defendant E.F. Hutton & Company Inc. ("Hutton Company"), a Delaware corporation and a wholly owned subsidiary of the defendant Hutton Group, maintains its principal offices at One Battery Park Plaza, New York, New York and regional and branch offices throughout the United States. It is one of the nation's largest broker-dealers of securities and is registered with the Securities and Exchange Commission pursuant to Section 15 of the Securities Exchange Act of 1934 [15 U.S.C §78o]

INTRODUCTION

9 At all times material herein, the defendant Hutton Company was organized into nine domestic operating regions and one international operating region. These regions were

Northeast Region in Boston, Massachusetts
Atlantic Region in New York, New York
Southeast Region in Atlanta, Georgia
Midwest Region in Chicago, Illinois
Central Region in Kansas City, Missouri
South Central Region in Houston, Texas
Mountain Region in Denver, Colorado
Pacific North Region in San Francisco, California
Pacific South Region in Los Angeles, California
International Region in Geneva, Switzerland

Each of these regions was supervised by a regional vice-president who reported directly to Hutton Company's president. In each of its domestic operating regions, the defendant Hutton Company maintained branch offices supervised by branch office managers. Regional and branch offices of the defendant Hutton Company also employed operations managers and cashiers who performed "back office" functions of the defendant's business. These regional and branch office operations managers and cashiers reported directly to their immediate supervisors, the regional vice-presidents and the branch office managers, and indirectly to defendant Hutton Company's operations managers in New York City.

10 At all times material herein, the defendant Hutton Company received from its individual and institutional customers, in the course of its business, between $40 million and $200 million each business day at its more than 300 branch offices located throughout the United States. Funds received from said customers were ordinarily first deposited in various local depository accounts maintained by the defendant Hutton Company in approximately 400 banks and financial institutions located throughout the United States.

11 As used herein, the terms "depository bank" and "depository account" shall mean the bank or account to which any instrument for the payment of money is transferred for collection. In many cases, as more fully set forth below, the defendant Hutton Company's stated purpose in having its branches open such accounts at depository banks was to use these accounts for the collection and concentration of funds received from its customers, and it was the expectation of these depository banks that such accounts would be so used.

12 At all times material herein, Hutton Company instituted and maintained a domestic "cash concentration" system, the legitimate purpose of which was to collect funds received from the defendant Hutton Company's individual and institutional customers, to transfer those funds to regional depository bank accounts and thereafter to transfer those deposits to certain prime depository bank accounts maintained in New York City and Los Angeles, California.

13 In general terms, this system, which was also known as the "drawdown system", operated as follows:

(a) Hutton Company branch office cashiers were instructed to calculate, on a daily basis, the net activity in their branch office's depository bank accounts and to transmit that information to their regional office cashiers. The regional offices maintained checks for each of the branch office depository accounts located in their regions, and the defendant Hutton Company's regional office personnel would thereafter prepare "depository transfer checks", or "DTC's", drawn upon each branch office depository account, and deposit these DTC's into the appropriate regional office depository bank accounts.

(b) Following the process described in subparagraph "(a)" above, the regional offices of the defendant Hutton Company would telephone its "Cash Desk" in New York City and report the aggregate net activity in the various regional depository bank accounts (which net activity included, as its primary component, the DTC's described above). Promptly thereafter, the Cash Desk would prepare DTC's drawn upon the regional depository bank accounts of the defendant Hutton Company's South Central, Southeast, Northeast and Atlantic regions and manually deposit those items into an account maintained at Manufacturers Hanover Trust Company, the defendant's prime concentration bank in New York City. Information as to the amount of funds deposited into the defendant Hutton Company's regional depository bank accounts for its Pacific North, Pacific South, Mountain, Central Midwest regions, was telexed by the Cash Desk in New York City to Bank of America, the defendant's prime concentration bank in Los Angeles, California. Bank of America, acting as agent for the defendant Hutton Company, immediately prepared DTC's drawn upon the aforesaid regional depository accounts for collection into the defendant's concentration account.

At various times material herein, the defendant Hutton Company's regional and branch office operations managers and cashiers were instructed to calculate the amount of funds to be draw down from their respective depository banks by using various forms known as "Drawdown Shee many of which required the aforesaid managers and cashiers to ascertain their depository bank' "ledger or book balance", rather than the bank's "available balance." By using a bank's ledger balance to calculate the amount which would be drawn down from branch and regional depositor banks, the defendant Hutton Company sought to obtain the use of funds representing not only the amount of its deposited customers' funds which had cleared but also funds in the process of collection. In addition to the foregoing, the computations required to be made using the Drawdown Sheets provided that on certain days of the week a "multiplier" would take effect increasing, by a factor of two, three or four, certain portions of the amount to be drawn down from a branch or regional depository bank.

(d) At various times material herein, the defendant Hutton Company maintained "zero balance" accounts at United States Trust Company of New York and Chemical Bank in New York City and Bank of America in Los Angeles. By arrangement with these banks, the defendant Hutton Company was permitted to draw checks upon these accounts — in which the defendant Hutton Company was required to keep no balance — with the understanding that it would, on a daily basis, wire transfer into these accounts sufficient funds to cover all checks presented against the accounts for payment. When these zero balance accounts were established, their stated purpose was that they would be used to cover clerical errors and returned customers checks, and the banks reasonably expected that the accounts would be used for these purposes.

SCHEME TO DEFRAUD

14. Beginning on or about July 1, 1980 and continuing through February 28, 1982, in the Middle District of Pennsylvania and elsewhere, the defendant Hutton Company devised and intended to devise a scheme and artifice to defraud and obtain money from various banks and financial institutions with which the defendant Hutton Company had established depository relationships as more fully set forth below.

OBJECT OF THE SCHEME

15. The object of the scheme and artifice to defraud was to obtain interest free funds by means of the intentional overdrafting of various of Hutton Company's depository bank accounts, in the manner and means more fully described herein.

MANNER AND MEANS OF EFFECTING THE SCHEME AND ARTIFICE TO DEFRAUD

16. It was part of said scheme and artifice to defraud that the defendant Hutton Company would and did fraudulently misuse its depository bank accounts, for the purpose of obtaining the interest-free use of bank funds, by manipulating the check collection system and procedures of the Federal Reserve System and causing repeated and substantial drawings against uncollected funds. This scheme and artifice to defraud, all in violation of Sections 1341 and 1343 of Title 18 of the United States Code, was accomplished by, among other things:

(a) drawing down arbitrary amounts unrelated to and in excess of the volume of customer funds deposited, and thereafter covering such excessive drawdowns by depositing checks drawn upon zero balance accounts of the defendant Hutton Company; and

(b) causing funds to be successively transferred between various branch and regional depository bank accounts of the defendant Hutton Company, prior to their deposit in a prime depository bank, thereby inflating the funds drawn down so that they exceeded the amount of customer funds originally deposited, and (i) utilizing in conjunction therewith formulas and methods by which the actual amount of customer funds was excessively multiplied or otherwise arbitrarily increased and (ii) exploiting the opportunities for delayed clearing times of items deposited into the defendant's branch and regional depository banks.

During the period from July 1, 1980 through February 28, 1982, the defendant Hutton Company's drawings against uncollected funds aggregated well in excess of $1 billion.

DRAFTING OF CHECKS IN EXCESS OF HUTTON COMPANY BOOK BALANCES

17. As a further part of the conduct described in paragraphs "14" and "16" above, and from on or about July 1, 1980 through February 28, 1982 the defendant Hutton Company, in the Middle District of Pennsylvania and elsewhere, knowingly executed and attempted to execute various modifications in the cash concentration or drawdown system for the purpose of facilitating the drafting, issuance and negotiation of checks drawn upon the defendant Hutton Company's branch depository accounts, which checks were arbitrary and unrelated to the amounts of Hutton's customer deposits.

18. As a further part of the conduct described in paragraphs "14" and "16" above, and from on or about July 1, 1980 to on or about February 28, 1982, the defendant Hutton Company, in the Middle District of Pennsylvania and elsewhere, knowingly executed and attempted to execute various modifications in the cash concentration or drawdown system for the purpose of artificially inflating the interest benefit to be derived therefrom. Defendant Hutton Company provided financial inducements and incentives to its branch office managers that, among other things, encouraged them to be more "aggressive" and "creative" in the overdrafting of their bank depository bank accounts. The financial inducements and incentives included crediting the branch offices with any interest benefits inuring to defendant Hutton Company arising out of the branch's relationship to its depository banks. In general, ten percent of the branch profits (which included interest charges and credits) were paid to the defendant Hutton Company's branch office managers as part of their compensation. Stimulated by the aforesaid inducements, and realizing that they could not employ the formulations of Hutton Company's Drawdown Sheet either "aggressively" or "creatively" without disregarding the formulations of the drawdown sheets, certain of defendant Hutton Company's branch office managers resorted to the only other available method for increasing the amounts drawn down from the branch depository banks — the withdrawal of wholly arbitrary and excessive amounts. For example, some branch office personnel using the draw down formulation, arrived at a final figure for withdrawal and then added a "zero", thereby increasing the amount of the withdrawal ten-fold. Others disregarded the Drawdown Sheets altogether, and withdrew arbitrary and excessive amounts.

CHAINING OF BRANCH AND REGIONAL DEPOSITS

19. As a further part of the conduct described in paragraphs "14" and "16" above, and from on or about May 1981 through February 1982, the defendant Hutton Company, in the Middle District of Pennsylvania and elsewhere, did further modify its stated cash concentration or drawdown system by causing various of its branch and regional offices to transfer, laterally or horizontally, from one branch depository bank or regional depository bank to another, funds withdrawn from various original depository banks. These horizontal or lateral drawdowns, or "chains", required the simultaneous, coordinated efforts of as many as 10 branch and regional offices of the defendant Hutton Company, in the communication of information and preparation of drawdown DTC's, to accomplish the transfer of "funds" from the original depository banks to the defendant's prime concentration banks. This increased the total dollar volume of drawdown checks in the system and thereby increased the potential interest benefit to the defendant Hutton Company, as hereinabove alleged, by increasing the opportunity for delayed clearing.

WHEREFORE, plaintiff, the United States of America, respectfully prays and demands:

1. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their officers, agents, employees, directors, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from use of the mails or wires, or means and instrumentalities of interstate commerce for employing any device, scheme or artifice to obtain for Hutton Company and Hutton Group any money, funds, credits or assets, owned by or under the custody or control of a federally chartered or insured financial institutional by means of false or fraudulent pretenses, representations or promises.

2. An order directing the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. to disclose and describe, in writing, to each bank or financial institution with which they maintain a depository account, all money management practices or techniques which may affect, directly or indirectly, the use of such account in connection with the concentration of funds, including, without limitation, intra-company transfers of funds into and out of such account.

3. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their officers, agents, employees, directors, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from drawing down, from any Hutton acccount at a depository bank, arbitrary amounts by means of overdraft checks unrelated to the volume of customer funds deposited, and thereafter covering such drawdowns by checks drawn upon another of Hutton's accounts.

4. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their officers, agents, employees, directors, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from causing funds to be successively transferred between Hutton's various branch and regional bank accounts, prior to their deposit in a prime depository bank, in order to inflate the funds drawn down so that they exceeded the amount of customer funds originally deposited; and (i) utilizing in conjunction therewith formulas and methods by which the actual amount of customer funds are excessively multiplied or otherwise arbitrarily increased and (ii) thereby exploiting the opportunities for delayed clearing times of items deposited into the defendants' branch depository banks.

5. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their officers, agents, employees, directors, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from causing uncollected funds to be withdrawn by any means, including the use of a multiplier or formula, from Hutton accounts in depository banks at which Hutton maintains a deposit relationship unless there are written agreements or consents of the banks authorizing such withdrawals.

6. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their officers, agents, employees, directors, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from withdrawing, by any means including the use of a multiplier or formula, from Hutton's accounts at depository banks funds in excess of funds actually received from customer or institutional clients in the ordinary course of business, unless there are written agreements or consents of the bank authorizing such withdrawals.

7. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their officers, agents, employees, directors, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from simultaneously drafting and issuing Hutton checks in identical amounts drawn on different banks, and cross-depositing each said check in the other bank, thereby causing each bank to certify next day opening balances in their account.

8. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their officers, agents, employees, directors, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from creating float by retarding, delaying or obstructing the clearing of checks deposited in the defendant Hutton Company's branch or regional depository banks other than by way of stop orders, directions not to pay or other credit related techniques.

And for such other relief as this Court deems appropriate under the circumstances.

DATED this 30th day of April 1985

/s/ ROBERT W. OGREN

Robert W Ogren
Chief, Fraud Section
U S Department of Justice
Washington, D.C 20530

/s/ ALBERT R. MURRAY, JR

Albert R Murray, Jr
Assistant U S Attorney
Scranton, Pennsylvania

/s/ PETER R. CLARK

Peter R Clark
Trial Attorney
U S Department of Justice
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Paul J. Guller, Chief Printer
Committee on the Judiciary
United States Senate
Room SR-374
Washington, D.C. 20510

Dear Mr. Guller:

Enclosed is the transcript of the April 17 hearing as corrected by Messrs. Fomon, Rittereiser, and Christopher. Messrs. Fomon and Rittereiser appeared on behalf of E.F. Hutton and Company, and Mr. Christopher joined them as counsel.

One of the corrections has been made for the purpose of accuracy, but may be construed to be a change of substance. On page 159, Mr. Christopher said that the information he had indicated that four banks were seeking to recover from the company outside the restitution program. He subsequently received updated information that five banks had undertaken such efforts, and that one of those banks was in litigation with the company. Please advise me if this correction will require approval of the Chairman; if so we will prepare an appropriate written request, to assure that complete figures are available in the proper context in the hearing record.

We will shortly be submitting some additional materials in response to requests from members of the Committee. Specifically, Senator Biden asked (Transcript, page 161) that Mr. Fomon share with the Committee the method by which the company arrived at the $8 million amount of the reserve set aside for the bank restitution program. In addition, we understand that after Messrs. Fomon and Rittereiser had been excused and had left the hearing, Senator Biden also asked that they respond in writing to his letter of April 1, which they had understood posed questions they were to be prepared to answer at the hearing. Responses to both of these inquiries will be forwarded in a few days.

Sincerely,

John Holum

John Holum
Special Counsel to
O'Melveny & Myers
Attorneys for E.F.
Hutton and Company

JH/sr

Senator HATCH. Mr. Ball, I will now call on you, sir. I welcome you, and you, Mr. Cutler, as well. We will swear you in.

Do you promise to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. BALL. I do.

Senator HATCH. We turn the time over to you, Mr. Ball. Do you have any statement for the committee?

TESTIMONY OF PANEL CONSISTING OF GEORGE BALL, CHIEF EXECUTIVE OFFICER, PRUDENTIAL-BACHE SECURITIES, NEW YORK, NY, ACCOMPANIED BY LLOYD N. CUTLER, COUNSEL, WILMER, CUTLER & PICKERING

Mr. BALL. I gave a statement when I testified at the Hughes committee. Perhaps I could enter it for the record rather than boring the two of you with a recitation of it.

If I could just summarize one or two lines, people sometimes can go on ad nauseum, but let me just mention two or three things.

Senator HATCH. Go ahead.

Mr. BALL. During my tenure at Hutton, I was not aware of any improprieties in the conduct of its draw-down system until February 1982 when Mr. Fomon told me that a problem had been brought to his attention by counsel, and that Mr. Fomon had told counsel to remedy the situation. Even thereafter, I was not included in meetings relating to the drawdown problems or possible modifications of that system.

I did not have knowledge of the responsibility for the deficiencies in Hutton's control mechanisms that resulted in its cash management system. I was, of course, aware that the firm had a cash management system which was designed to bring money in from branches to its headquarters as quickly as possible, and that this utilized overdrafting against uncleared check deposits. I was not aware of the specific methods used to reach that result.

A number of memos that I have annotated on and that have been sent to me that I in turn disseminated have been cited. I think it would be fair to cite that I was a very prolific memo writer and distributor. I really believe that communication is good. I did not parse every word. I did not study in detail the implications of every phrase, nor do I think that there were improprieties in those memoranda, but I think that, really, the more management does to try to communicate about a business in all of its dimensions—you have just heard about things that relate to cash management systems, but as to communications costs or to improve the sale of legitimate tax shelters or what have you—they are a part of the job and something that was done and done quite well at Hutton.

With that, let me not bore you further.

[Statement follows:]

United States House of Representatives
Committee on the Judiciary
Subcommittee on Crime
October 31, 1985

Prepared Statement of George M. Ball

Thank you, Mr. Chairman and Members of the Subcommittee:

I welcome the opportunity you afford me to answer your questions this morning concerning E.F. Hutton's cash management practices during the time I was associated with that firm.

As you may know, I became president of E.F. Hutton in 1977, having been its national retail sales manager for the preceding seven years. I left E.F. Hutton in July, 1982.

While I was president of E.F. Hutton, my responsibilities continued to be primarily those of the management of the retail sales function. I was not the firm's chief operating officer. Like a number of other senior Hutton officers, I reported directly to Robert M. Fomon, chairman and chief executive officer. Those others reporting directly to him included the chief financial officer, the head of operations and the company's general counsel, each of whose functions have been integral to your inquiry. In addition, the heads of the corporate finance, public finance and trading also reported directly to Mr. Fomon.

I underscore the diffuse nature of Hutton's management structure to provide you with a better understanding of its corporate system without attempting to suggest I was a minor figure in the company. To the contrary the retail sales force which reported to me consisted of over 4,000 account executives and generated revenues of over one billion dollars a year by the time I left Hutton in July 1982.

During my tenure at Hutton, my knowledge of the drawdown system was sketchy at best. I was not aware of any improprieties in its drawdown system until February, 1982, when

Mr. Fomon informed me that a problem had been brought to his attention by counsel and that he had told them to remedy the situation. Even thereafter, I was not included in meetings relating to drawdown system problems or possible modifications to that system. Simply put, I had no knowledge of, nor responsibility for, the deficiences in Hutton's control mechanisms that resulted in the abuse of its cash management system.

I was of course aware that the firm had a cash management system designed to bring money from its branches to its headquarters as quickly as possible to minimize the loss of interest on float to banks. I was also aware that this system utilized overdrafting against uncleared check deposits as a means to reduce the loss of float. I was not aware of the procedures or specific methods used to reach that result. I certainly was also not aware that some regions and branches were abusing that system in order to generate additional interest income by excessive overdrafting or chaining.

As you know, I was a prolific memo and note writer, and consistently encouraged employees to achieve excellence in each aspect of their work. In my experience, there is no sales person, no manager, no worker, who has reached the maximum of his or her abilities. That is true at Hutton and elsewhere. However, one should not mistake a search for improvement for a willingness to cut corners. Exhorting branches to increase their interest profits or stock sales or cost effectiveness, was in no way a call for sharp practices.

To the contrary, on several occasions in the course of reviewing the financial results of the branches, I sent memoranda to my colleagues asking questions about branch profit margins and interest income that appeared unusually high. In some cases the memos related to branches that, according to Judge Bell's recent report, he exonerated from any responsibility for abusive practices. In other cases, the memoranda related to branches that, according to Judge Bell's report, did engage in abusive actions. At no time did I receive a reply indicating any impropriety.

Mr. Chairman, I would be pleased to answer any questions that the Committee may wish to ask.

Senator HATCH. Thank you, Mr. Ball. I am not going to ask any questions. I will turn the time over to Senator Biden.

Senator BIDEN. I have three short questions, Mr. Ball. First of all, the Bell report, as you know, characterizes you from 1980 through 1982 as the leading advocate of, quote, increased interest, end of quote, income. Were you one of the leading advocates?

Mr. BALL. Yes, Senator. If I can just expand in one sentence.

Senator BIDEN. Sure. Go ahead.

Mr. BALL. Interest income, yes; of lower costs, yes; and yes, to higher security sales revenues.

Senator BIDEN. The Bell report also finds that you did not know that the interest program was being run illegally; that is, zeros being added. I assume that is what he means by illegally, and the chaining. Is that true?

Mr. BALL. Yes, sir.

Senator BIDEN. Should you have known, in retrospect, as a good manager and communicator?

Mr. BALL. I do not believe so. It is a question I have asked myself a number of times. The control mechanisms were in parts of the firm that did not report to me. Now, I am not trying to lay the fault or the blame off on somebody else, but the oversights—the internal audit, the bank reconciliation, the money mobilization departments did not report to me directly or indirectly. So other than by finding a needle randomly in a haystack, I do not know how I could have.

Senator BIDEN. What could you have done differently that would have permitted you to know, or what policy could the corporation have instituted or had in place that would have permitted you to know?

Mr. BALL. We all tend to fight the last war and not to know what is going to go on in the next one. I would say in the 1982 period that neither I nor—that I certainly did not have any idea that there could be abuses in drawdown systems, period.

Senator BIDEN. One of the things we are driving at is that I am one of those people who believes that, in one sense, corporate America has to get bigger if we are going to compete internationally. I am one of those folks who thinks that our antitrust laws, not as your basic security industry, but our antitrust laws have to be looked at again. I will tell you what worries me, quite frankly, is the increasing incidence of the inability of 19th century law relating to accountability being applied to 21st century organizations.

All of you guys and women who are, and I am not being facetious, high-powered corporate executives come and tell me, hey, Joe, I cannot possibly know. Now, one of the purposes of this hearing, again, is not to—had I been a prosecutor, I would have been on your ear more than I think they were, but that is another question. That is over. One of the purposes I have now, how do I resolve the dilemma? Corporate America on the one hand says yes, Joe, we need to move along, we need to get more power in terms of economic power, ability to compete, ability to get bigger; and at the same time they say, Joe, lessen my personal responsibility, whether it is treble damage, whether it is personal responsibility, whatever it is. And, see, I hope you in the corporate community, and maybe this message can be extended to anybody in the corporate community that is going to listen to these hearings and anything I have to think about it, I hope you begin to address for me, especially if, God forbid, we end up taking over this committee and I become the chairman. Because I want to tell you, I am going to be very, very necessary to deal with in doing this. And unless you in corporate America can answer for me how you are not only going to need more latitude in competition, but how you are going to produce the prospect of greater responsibility to the public, I am going to have difficulty giving more latitude, to the extent that I play a part.

I mean, that is really the context. It is hard in these kinds of hearings to sometimes keep in focus the forest. We concentrate on a tree. The adding of zeros is the tree. The forest, for me, is what do we do about it from here. That is the reason why I ask you the question.

So if you, in an editorial sense, and you specifically cannot answer for me how you would create a corporate structure that would know whether or not someone is adding zeros, to use that euphemism now, then what happens is your aggressive management plans–and you, in an editorial sense——

Mr. **Ball**. I understand.

Senator **Biden** [continuing]. Which says that, hey, we are going to base you, the branch manager's income on your ability to increase profits. We do not care how you do it; do not let me know. Basically that is the message. So you have what your attorney knows better than I, having gone through the years here and counseling and many people involved and many situations, you have the plausible denial defense that is one which, in my view, does more to undermine the legal system and the confidence of the American people in their Government and their major institutions. And lastly to this, you know my whole thinking; not that you care about it, but I predict to you if the answer is not forthcoming, if we cannot resolve this, we will go from a very probusiness climate which exists now to, when things turn around, you will see the vengeance of the populace visited upon corporate America in a way that you will wish you had cooperated with me and others like me to provide a system of accountability which I would argue is not non-existent, but is, at best, a shadow in corporate America.

Do you understand my rationale? In light of that, would you answer for me, and I will not say any more, Mr. Chairman, can you tell me either now or for the record how you would organize or reorganize E.F. Hutton so the man in your position with your authority would be able to know about those folks adding the zeros?

Mr. **Ball**. Perhaps I can best answer, in fairness and directly, by talking about Prudential Bache, the firm to which I moved. And if I could philosophize for 8 seconds and no longer.

Senator **Biden**. No, take your time. You listened to me. Do not think because of my exasperation with the former witnesses that I am reluctant to let people answer fully. I just thought they did not want to answer my questions. But go ahead. You are answering them.

Mr. **Ball**. It is an increasingly complex society of business. It is difficult for people like Bob Fomon or me because we have to rely more and more on others. All right. That is one of the conundrums.

You cannot know it all yourself. You have got to have smart people.

In the case of Prudential-Bache, what I did eventually when I moved there was appoint a chief administrative officer and say to him, a very high level person, please pull the control systems together so that if something goes wrong we catch it fast, and so that there are checks and balances. That will never work perfectly. You see, even as I say it, I know that the best control systems like the *Challenger* space shuttle are going to fail occasionally. But if one does not expect perfection, but rather an honest attempt, then I think mechanically, organizationally, that is the right way to do it.

There is one other element. I am not a lawyer so I really cannot help you on that side of it. The question of ethical responsibility in business needs to be addressed by all of us. Teach it, preach it, act it, support it. And it is something that we are not unaware of, and I am not going to say that we can get it with ease. But probably it is something that has not been as highly and actively espoused by all of us as it ought to be. We have got to change that, or the laws are going to come down on our heads. But we have got to do something to keep the avalanche from deservedly falling on our heads.

Senator BIDEN. Well, I would just conclude by saying to you that the same argument can be made about the difficulty of high level elected political officials. We have no reluctance of imposing laws which require severe accountability upon them. I realize the function of the economy and the job my father and brother has depends a lot less on whether or not I function well than on whether or not the chairman of the board of DuPont and Morris functions well.

But nonetheless, I hope the business community from this experience is somewhat chastened by the fact that, A, when they are judgmental about those of us who have similarly elongated responsibilities, but we can still go to jail for them or be held accountable for them. And a similar kind of psychology exists within the community.

Maybe it has occurred, but I am waiting for the first series, the first resolution to come out of the Business Roundtable that calls for a major symposium on ethics in business and one that is held biannually or annually. I am waiting for that to occur. I think it would be a nice sign. If you were smart and I were your lawyer, I would know how to make you all look a lot better, you, the business community. I think it is time to respond before other people respond. Mark my words: The house of cards is going to fall, and it will hurt all of us in the country. It will hurt our economy, and you all will be the reason for it for not acting.

Mr. BALL. I work for the current chairman of the Business Roundtable.

Senator BIDEN. Give him my advice.

Mr. BALL. And I will see if I can get your idea turned into action, sir.

Senator BIDEN. Thank you.

I have no further questions.

Senator HATCH. Thank you, Senator Biden. I believe that corporate America should make a greater effort to ensure that ethics in business really is taught. I also believe that our business schools need to do a better job of promoting ethics.

I also agree that matters like these are very difficult to ferret out, and just because a man is a senior executive officer or top executive officer, it does not mean he knows every little jot and tittle that goes on in those corporations.

And you and I both know there is much to be desired in every entity in our society, not just business. I can tell you there is a lot to be desired around here. And we do not very often impose the same restrictions on ourselves that we do on everybody else, even though I think there are some very severe restrictions on Members of Congress.

To make a long story short, I think these hearings are important because I think they bring everybody's attention to how important it is to be on top of what is right and what is wrong in corporate America and our society today.

I am just sorry I missed the first part of the session with the Justice Department. Joe tells me he was brilliant, but I would expect nothing less.

All right. But I would only add this: That if the Democrats do take over, regardless of how good Joe is and fair and evenhanded he will be, you can count on corporate America being under a much greater onslaught than they are right now. There is no question about that.

Senator BIDEN. I want to assure you that if the Democrats take over, I am voting for Ted Kennedy for chairman of the committee.

Senator HATCH. There is a very good reason for us to stay in power. [Laughter.]

Senator BIDEN. As Huey Long said, "I lied." I am joking. I said I had no more.

Mr. Chairman, I sent to Mr. Ball, Mr. Fomon and Mr. Ritterreiser identical letters dated April 1, 1986, that asked them to respond to certain questions. I wonder if you have had a chance to respond to that letter yet. Have you? And if not, are you willing to?

Mr. CUTLER. Mr. Chairman, Mr. Ball did not receive such a letter. But we have seen the one addressed to Mr. Fomon, and we would be very happy to answer it.

Senator BIDEN. Good. I would ask that they be incorporated into the record.

Senator HATCH. Without objection, we will incorporate them in the record, and we hope that all witnesses who have received these letters will respond.

[Information follows:]

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United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510

April 1, 1986

Mr. George Ball
Chairman and CEO
Prudential-Bache Securities
One Freeport Plaza, 34th Floor
New York, NY 10292

Dear Mr. Ball:

I write to you in advance of the Judiciary Committee's scheduled hearing on the White-Collar crime hearings, in which you have been invited to testify, because I wanted you to have the opportunity to think over at least one question before your appearance.

In 1961, General Electric and 29 other electrical equipment manufacturers, who, together, controlled 95 percent of the market, were convicted of conspiracy to fix prices. The middle level executives, who were charged and convicted, said price-fixing in the industry was an established practice. The company presidents, who were neither charged nor convicted, said they were unaware of the practice.

Following the convictions, a number of civil suits were brought against the principal executives of the companies. that charged mismanagement. One of the more prominent of the suits was *Graham v. Allis-Chalmers Mfg. Co.*, 41 Del. Ch. 78, 188 A2d 125 (1963). In *Graham*, the Court held that the executives were not civilly liable to the corporations for the damage done to the corporation by the conduct of their subordinates in fixing prices in the absence of a showing that they knew of the activity and failed to act. Similarly, they had no duty to institute a program within the company to uncover wrongdoing unless they had grounds to be suspicious that wrongdoing might be occurring. *Graham* followed the lead of the Supreme Court's decision in *Briggs v. Spaulding*, 141 U.S.132,145-42 (1891).

The *Briggs* decision , of course, was handed down at the end of the 19th century, and it reflected the wisdom of an era of laissez-faire capitalism and caveat emptor. My thought is to test its contemporary vitality with you in light of recent events and a new era with more concern for responsible conduct.

Repeatedly, studies have shown a disturbing pattern of corporate recidivism. In his classic study, in 1940, *White-Collar crime*, Edwin H. Sutherland examined seventy of the largest manufacturing mining and mercantile corporations in this country. Over an "individual life career" of forty-five years, the seventy corporations had an average of four criminal convictions each. Subsequent studies have found no difficulty in replicating Sutherland's findings. *See e.g., M. Clinard, Illegal Corporate Behavior* (1979). Indeed, I note that G.E. has only recently plead guilty to defrauding the United States in connection with the Minuteman missile program. In light of these studies, I wonder how valid it is to assume in large organizatons today that no action is required to anticipate, rather than to react to, wrongdoing by subordinates?

As I see it, the executive of a large organization faces, at the extreme, two courses of action, neither of which is attractive. He or she can centralize in his or her office most, if not all, of the crucial decisions of the organization, but lose the flexibility required in a free enterprise economy of on the spot decision-making. On the other hand, he or she may delegate to his or her subordinates most, if not all, of the crucial decision-making power in light of general policy standards and hold the subordinates responsible for achieving various corporate goals. While that course of action retains the benefit of decision-making near to the problem, it may divorce high level policy-makers in a corporate organization from information they need to protect the corporation from wrong doing by subordinates.

As a society, we have accorded great wealth and prestige to corporate leaders, and by and large, we have prospered as a nation by doing so. We give them credit for the successful economic performance of the organizations they head. Appropriately and fairly, should we not also hold them accountable for wrongdoing by the organization?

Do we need to rethink our standards of what constitutes good management techniques in large organizations in light of corporate wrong doing?

Do we need to change our legal standards of responsibility to assure that good management techniques are followed?

I look forward to your thoughts and suggestions.

Sincerely,

Joe Biden

Joseph R. Biden, Jr.
United States Senator

Senator **Hatch**. I want to thank everybody for your cooperating today. These hearings are efficacious, as far as I am concerned. We appreciate having you here. It is good to see you again, Lloyd.

Mr. **Cutler**. Thank you, Senator.

Senator **Hatch**. With that, we will recess until further notice.

[Whereupon, at 6:13 p.m., the committee adjourned, subject to the call of the Chair.]

WHITE COLLAR CRIME—PART 3
(E.F. Hutton)

THURSDAY, MAY 8, 1986

U.S. Senate,
Committee on the Judiciary,
Washington, DC.

The committee met, pursuant to notice, at 2:25 p.m., in room SD-226, Dirksen Senate Office Building, Hon. Joseph R. Biden, Jr., (acting chairman) presiding.

Also present: Senators Metzenbaum, Grassley, and Specter.

Staff present: Michael Regan, counsel; G. Robert Blakey, minority special counsel; Dorothea Constantinides, minority staff assistant, and Lisa Hovelson, legislative assistant.

OPENING STATEMENT OF SENATOR JOSEPH R. BIDEN, JR.

Senator Biden. The committee will come to order.

I have an opening statement, as I suspect my colleague does, but our colleague from the House side, "the other body", as we affectionately refer to it, has a bit of a time constraint, and we would like to accommodate that; so, with your permission, Senator Metzenbaum, why don't we allow our colleague to make his statement, and then he can tell us how much time he has, if he has time for questions.

Senator Metzenbaum. Fine.

Senator Biden. Before I call the first witness, I wish to place an opening statement of Chairman Thurmond in the record.

[Statement follows:]

Prepared Statement by Chairman Strom Thurmond

Today the Judiciary Committee concludes the hearings on the E.F. Hutton investigation which have been part of a series of oversight hearings on white collar crime. The Committee will first hear testimony from the Honorable Bill McCollum, the Ranking Republican on the Subcommittee on Crime of the House Judiciary Committee, which has conducted and extensive investigation of the E.F. Hutton case. The Chairman of the Subcommittee, the Honorable William Hughes was invited to testify, but is unable to appear today. The Committee is also pleased to have Judge Griffin Bell appear today to testify about the E.F. Hutton case and his own internal investigation of that company.

Congressman McCollum will provide valuable insights into the essence and results of the House Judiciary Committee investigation of E.F. Hutton. The internal investigation by Judge Bell reviewed cash management practices at E.F. Hutton, determined how those practices evolved, identified the individuals who bear personal responsibility, and made recommendations with respect to those individuals and the Company. It is my understanding that E.F. Hutton cooperated fully in that investigation. Therefore, he is uniquely qualified to testify before this Committee about the internal problems at E.F. Hutton which led to the plea agreement and the remedies recommended by you and implemented by the Company. I do not believe that a full and fair review of the E.F. Hutton case is possible without testimony on your important and valuable investigation. Additionally, I welcome your comments as the former United States Attorney General on the Justice Department's prosecution of this case and the consequent Congressional investigation. I welcome both of you today and I look forward to receiving your testimony.

Senator BIDEN. Welcome, Congressman. Thanks for making the trip over.

STATEMENT OF HON. BILL McCOLLUM, MEMBER OF CONGRESS, STATE OF FLORIDA

Mr. McCOLLUM. Thank you, Senator.

Senator Biden, Senator Metzenbaum, I appreciate the chance to come over and your hospitality in letting me advance your opening statements.

I have had the privilege of being on the House Judiciary Committee for the last 6 years, and the last year or two, I have been the ranking Republican on the Crime Subcommittee. We have also conducted oversight hearings of the E.F. Hutton bank fraud prosecution.

So I thought today, with your good graces, I would share with you just a few of my thoughts about it, to perhaps help you with your analysis. You obviously will draw your own conclusions from this whole process, as I have. And I will be very brief, because I do not have time to go into the whole statement. It is in the record, and I would certainly hope that I could submit it officially for your record.

Senator BIDEN. Yes. The entire statement will be put in the record as if read.

Mr. McCOLLUM. Thank you, Senator.

The Congress, in my judgment, Senator Biden and Senator Metzenbaum, has a duty to oversee the proper workings of the executive branch. The Committees on the Judiciary of each body have the greatest portion of this duty and I believe the most difficult, because we must oversee the implementation of the criminal justice system without interfering with the prosecutorial discretion.

I have waged an internal debate for the last 10 months regarding the extent to which legitimate oversight jurisdiction can be exercised before it becomes in and of itself a form of political pressure.

When we are truly studying an issue and a policy, I believe we are fulfilling our duty. But when we begin second-guessing and criticizing nonpolitical prosecutors for decisions that are well within their proper prosecutorial discretion, we have crossed the line and may do more harm than good.

I most regretfully conclude that our Subcommittee on Crime interrogation of nonpolitical prosecutors and investigators, will have the unintended result of causing these dedicated officials to shy away from the very complex, controversial white collar crime cases that we want them to attack. Our after-the-fact criticism makes such cases a no-win proposition for the prosecution. In effect, I am afraid we have accomplished a result opposite from that which we originally intended, and to this degree, I sincerely regret that.

I hope that my thoughts on our Subcommittee investigation will be of benefit to you. There are really just two questions that I think are essential to the oversight of the E.F. Hutton matter.

First, did the prosecutors engage in any impropriety?

I have nct, in listening to hours of testimony, discovered any indication of wrongdoing on the part of the Assistant U.S. Attorney Albert Murray, or his colleagues in the fraud section, or their superiors.

The second question is did these line prosecutors become subject to any, even the slightest minutia, of political pressure from their superiors?

In this regard, there has been a flood of speculation, and there was a lot of testimony hither and yon. However, not only have we not uncovered any evidence of political influence; the Subcommittee on Crime of the House has uncovered evidence that political influence did not occur and, in the case of the famous lunch, could not have occurred because the decision that Hutton had hoped to influence was already made before that lunch even took place.

I was one of those people who from the very beginning was troubled by the seeming inconsistency that such a large fraud on the public could be perpetrated and punished without any of the perpetrators going to jail. And I know some of you share that same concern.

It is nothing short of outrageous until we assess the terrible loopholes in the law and the absence of evidence against the high-level Hutton officials.

To help you understand my analysis of this issue without consuming all afternoon, I have attached a flow chart that I think explains pretty much how I have reasoned through these views, and I hope that will be particularly of help.

First is a list of several different Hutton cash concentration systems. Then you will see that the loopholes existing in the criminal laws and the defenses applicable to the Hutton schemes made prosecution of only the most serious schemes possible.

Finally, all of the evidence implicating the highlevel officials that I have seen applies to the schemes outside the Federal criminal laws.

Assistant U.S. Attorney Al Murray and his colleagues should be praised for the results they achieved in this matter, not criticized.

The ingenuity of the prosecutors is highlighted by the civil injunction in which the scope of criminal law under the new bank fraud statute is extended to incorporate all of the Hutton activities. If this matter had gone to trial, not only would it have been impossible to convict any senior corporate officers of a crime, but there would have been no way to stop E.F. Hutton from highly undesirable cash management practices that they agreed to stop as a part of their plea bargain agreement.

At the same time, we should not lose sight of the fact that the fines levied against Hutton were the largest fines ever assessed for white collar crime in the United States.

If the case had been tried, these important factors and these important decisions would not have been possible.

The prosecutors had a hard sell with their superiors, but in the end, the same reasoning, the same objective standards that I think prevailed with the superiors, should prevail with us after we finish our oversight.

The resolution as far as I am concerned is not a popular one. It was not popular when I went into my hearings; I am sure it is not popular over here. But we have to remember that popularity should never be a factor within the scope of prosecutorial discretion. I frankly cannot find any improper activity on the part of the Department of Justice of any official of the Department of Justice or any nonpolitical line prosecutors. The hoopla just dissipates in my judgment when we finish looking at it.

I think I have raced through this in enough time maybe for a few moments of questioning. I certainly want to allow that. I do not want to run out in haste on my colleagues, but I will not spend much time with you, as I unfortunately do not have it.

[Statement follows:]

TESTIMONY OF THE HONORABLE BILL McCOLLUM
BEFORE THE COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

Mr. Chairman and distinguished members of this Committee,

It is indeed a pleasure for me to be here today to discuss but one of the many issues within the jurisdictions of the Committees on the Judiciary of both Houses. This is my first term as the Ranking Republican on the Subcommittee on Crime and my third term as a Congressman and member of the House Judiciary Committee. As a representative from the state of Florida, I have a keen interest in immigration and law enforcement issues.

The Subcommittee on Crime focused its oversight jurisdiction solely on the E.F. Hutton bank fraud prosecution from June, 1985 through the present. I am hopeful that our investigation will soon draw to an end so that the Subcommittee can devote its full attention to its legislative agenda, and work with you toward the enactment of legislation addressing terrorism, drug trafficking, money laundering, controlled substance analogs and other issues of great importance to the American people.

The Congress has a duty to oversee the proper workings of the executive branch. The Committees on the Judiciary have the greatest portion of this duty and, I believe the most difficult one, because we must oversee the implementation of the criminal justice system without interfering with prosecutorial discretion. I have waged an internal debate for the last ten months regarding the extent to which legitimate oversight jurisdiction can be exercised before it becomes in and of itself a form of political pressure. Where we are truly studying an issue and a policy, I believe we are fulfilling our duty. But when we begin second guessing and criticizing non-political prosecutors for decisions that are well within proper prosecutorial discretion, we have crossed the line and may do more harm than good.

I most regretfully conclude that our Subcommittee on Crime interrogation of non-political prosecutors and investigators will have the unintended result of causing these dedicated officials to shy away from the very complex, controversial white collar crime cases that we want them to attack. Our "after the fact" criticism makes such cases a no win proposition for the prosecutors. In effect, I am afraid that we have accomplished a result opposite from that which we originally sought, and I sincerely regret that.

I hope that my thoughts on our Subcommittee investigation will be of assistance to you in understanding this thoroughly complex fraud and the resulting prosecution. There are two questions that are essential to this inquiry. First, did the prosecutors engage in any impropriety. I have not found evidence of any wrongdoing on the part of Assistant United States Attorney Albert R. Murray, Jr., his colleagues from the Fraud Section, or their superiors.

The second question is did these line prosecutors become subject to any, even the slightest minutia, political pressure from their superiors. In this regard there has been a flood of speculation. Not only have we not uncovered evidence of political influence, the Subcommittee on Crime has uncovered evidence that political influence did not occur, and, in the case of the famous luncheon, could not have occurred because the decision that Hutton hoped to influence was already made before the lunch even occurred. I am not going to spend a great deal of time on this juicy issue except to share with you the document that proved to me the irrelevance of the lunch between Mr. Fomon and then Attorney General William French Smith to the prosecutors slaving away on this case in Pennsylvania as the second grand jury was about to expire.

I have attached an undated memo that was sent by Trial Attorney Peter B. Clark to the Chief of the Fraud Section, Mr.

ROBERT W. OGREN. WE KNOW THAT THIS MEMO WAS READ AND ACKNOWLEDGED BY CHIEF OGREN IN HIS OWN HANDWRITING ON NOVEMBER 14, 1985 OR EARLIER, BECAUSE ON THIS DAY CHIEF OGREN TRAVELED FROM WASHINGTON AND DID NOT RETURN UNTIL AFTER THE GRAND JURY WAS EXTENDED. THE MEMO CLEARLY STATES THE PROSECUTORS' INTENT TO EXTEND THE GRAND JURY ON THAT FRIDAY, NOVEMBER 16, 1985. THE SOCIAL LUNCH IN WHICH MR. FOMON BY ALL ACCOUNTS AMBUSHED THE ATTORNEY GENERAL WITH A REQUEST TO EXTEND THE GRAND JURY DID NOT OCCUR UNTIL THURSDAY, NOVEMBER 15. FROM THE PROSECUTOR'S PERSPECTIVE, THIS INAPPROPRIATE LUNCH WAS A NON-EVENT. IT COULD NOT HAVE INFLUENCED THEM BECAUSE THEIR DECISION WAS ALREADY BEING IMPLEMENTED THE DAY BEFORE THE LUNCH, AND AS YOU CAN SEE FROM THE MEMO, A LARGE NUMBER OF PEOPLE WERE AWARE OF THEIR PLANS.

I WAS ONE OF THOSE PEOPLE WHO, FROM THE VERY BEGINNING, WAS TROUBLED BY THE SEEMING INCONSISTENCY THAT SUCH A LARGE FRAUD ON THE PUBLIC (THE BANKS' LOST INTEREST IS, AFTER ALL, BORN BY THEIR CUSTOMERS) COULD BE PERPETRATED AND PUNISHED WITHOUT ANY OF THE PERPETRATORS GOING TO JAIL. IT IS NOTHING SHORT OF OUTRAGEOUS UNTIL WE ASSESS THE TERRIBLE LOOPHOLES IN THE LAW AND THE ABSENCE OF EVIDENCE AGAINST THE HIGH LEVEL HUTTON OFFICIALS.

TO HELP YOU UNDERSTAND HOW I ANALYZE THESE ISSUES WITHOUT CONSUMING MUCH OF YOUR AFTERNOON, I HAVE ATTACHED A SIMPLISTIC CHART AT THE END OF MY VIEWS. FIRST THERE IS A LIST OF THE SEVERAL DIFFERENT HUTTON CASH CONCENTRATION SYSTEMS. THEN YOU WILL SEE THAT THE LOOPHOLES IN EXISTING CRIMINAL LAWS AND DEFENSES APPLICABLE TO THE HUTTON SCHEMES MADE PROSECUTION OF ONLY THE MOST SERIOUS SCHEMES POSSIBLE. FINALLY, ALL OF THE EVIDENCE IMPLICATING HIGH LEVEL OFFICIALS THAT I HAVE SEEN APPLIES TO THE SCHEMES OUTSIDE THE FEDERAL CRIMINAL LAWS.

ASSISTANT UNITED STATES ATTORNEY AL MURRAY AND HIS COLLEAGUES SHOULD BE PRAISED FOR THE RESULTS THEY ACHIEVED IN THIS MATTER, NOT CRITICIZED. THE INGENUITY OF THE PROSECUTORS IS HIGHLIGHTED BY THE CIVIL INJUNCTION IN WHICH THE SCOPE OF

CRIMINAL LAW UNDER THE NEW BANK FRAUD STATUTE IS EXTENDED TO INCORPORATE ALL OF THE HUTTON ACTIVITIES. IF THIS MATTER HAD GONE TO TRIAL NOT ONLY WOULD IT HAVE BEEN IMPOSSIBLE TO CONVICT ANY SENIOR CORPORATE OFFICERS OF A CRIME, THERE WOULD HAVE BEEN NO WAY TO STOP E.F. HUTTON FROM HIGHLY UNDESIRABLE CASH MANAGEMENT PRACTICES THAT THEY AGREED TO STOP AS A PART OF THEIR PLEA BARGAIN. AT THE SAME TIME WE SHOULD NOT LOSE SIGHT OF THE FACT THAT THE FINES LEVIED AGAINST HUTTON WERE THE LARGEST FINES EVER ASSESSED FOR WHITE COLLAR CRIME ACTIVITY IN U.S. HISTORY OR THAT BANK RESTITUTION WAS AVAILABLE TO ALL AFFECTED BANKS. IF THE CASE HAD BEEN TRIED, THESE IMPORTANT FACTORS WOULD NOT HAVE BEEN POSSIBLE.

THESE PROSECUTORS APPARENTLY HAD A HARD SELL WHEN THEY TOOK THEIR PROPOSAL, WHICH DID NOT INCLUDE THE PROSECUTION OF INDIVIDUALS, TO ASSISTANT ATTORNEY GENERAL STEPHEN S. TROTT, WHO WAS ULTIMATELY CONVINCED OF THE BENEFITS OF THIS PARTICULAR PLEA AGREEMENT FOR THE SAME REASON ANYONE WHO OBJECTIVELY REVIEWS THIS MUST BE. EVEN SO, IT WAS AN EXCELLENT AGREEMENT AND THE BEST OUTCOME THE GOVERNMENT COULD HOPE TO ACHIEVE WITH OR WITHOUT PROSECUTION.

THIS RESOLUTION WAS NOT A POPULAR ONE, BUT WE MUST ALL REMEMBER THAT POPULARITY SHOULD NEVER BE A FACTOR WITHIN THE SCOPE OF PROSECUTORIAL DISCRETION. I FRANKLY CANNOT FIND ANY IMPROPER ACTIVITY ON THE PART OF ANY DEPARTMENT OF JUSTICE OFFICIAL OR NON POLITICAL LINE PROSECUTORS. THE HOOPLA JUST DISSIPATES WHEN YOU BEGIN TO UNDERSTAND THESE EXTRAORDINARILY COMPLEX FACTS.

ATTACHMENT A

[illegible] Clarke

Bob:

According to Al Murray, Steve Trott was asked by Dave Queen to call Ken Fletcher, the Chief Postal Inspector (245-5445) to request that the Postal Service maintain their level of commitment on the Hutton case during the period that the grand jury will be extended. Apparently the regional inspector in Philadelphia has said he wants to pull the team off until the case is indicted. I'm not sure we need to remind Steve to do something, but Murray has asked that we inquire as to whether Steve has spoken with Fletcher. Since you have had the contact with Steve on Hutton, it might be better if you asked him.

I'll be in Harrisburg on Friday, and will file the motion to extend the grand jury's term. If you speak with Steve, please let me know the result so I can tell Murray and Queen.

Peter

Attachment B

E.F. HUTTON BANK FRAUD INVESTIGATION

Hutton cash management schemes	Provable violation of bank fraud	Evidence of knowledge by high level Hutton officials	Evidence of knowledge by other Hutton employees
Basic Cash concentration scheme		X	X
Target Balancing		X	X
Check misencoding			X (some)
Check criss-crossing			X (some)
Arbitrary overdrafting	X		X (DoJ had sufficient evidence to charge 2 employees)
Chaining	X		X (DoJ had sufficient evidence to charge 2 employees)

E.F. HUTTON BANK FRAUD INVESTIGATION

CIVIL INJUNCTION
No provable mail fraud violations for these acts:

TARGET BALANCING (T.B.)(Hutton claimed that so long as a positive balance existed over time, overdrafts on some days were legal) Not provable because Hutton would claim:

-Prosecution would have been an obvious circumvention of Williams & Frankel;

- T.B. was a common industry practice, Hutton engaged in aggressive cash management in good faith;

-Banks sold T.B. services and knew of the practice; and

- Individuals merely followed corporate policy.

CHECK CRISS-CROSSING: Not provable since banks knew or should have known of this distinct activity.

CHECK MISENCODING: Insufficient evidence of deliberate misencoding.

EVIDENCE OF INDIVIDUAL INTENT:

T.B. - Many memos detail awareness and support of T.B. by high level officials (the front office). Back room, regional and branch employees carried out this system.

CRIMINAL PLEA
These acts were Mail fraud violations:

CHAINING & ARBITRARY OVERDRAFTING (neither chaining or overdrafting have any legitimate cash concentration purpose).

Hutton made the following criminal misstatements to the banks:

-Bank accounts were for local customer deposits, not the huge amounts of N.Y. money hutton deposited into these accounts; &

-Bank accounts were functional depository accounts, but not interest bearing accounts as Hutton used them (to obtain interest free, unsecured loans).

Hutton defenses to criminal charges for T.B. did not apply to chaining and overdrafting.

EVIDENCE OF INDIVIDUAL INTENT

Insufficient evidence of front room knowledge of chaining or arbitrary overdrafting. Some back room, branch, & regional personnel had criminal knowledge of scheme being carried out by many of these employees (DOJ had evidence to charge 2 individuals).

EMBARGOED UNTIL WEDNESDAY, MAY 7TH AT 10:A.M.

COMMITTEE ON THE JUDICIARY

SUBCOMMITTEE ON CRIME

UNITED STATES HOUSE OF REPRESENTATIVES

STAFF ANALYSIS OF "THE HUTTON REPORT" BY GRIFFIN BELL

February 1986

HIGHLIGHTS OF BELL REPORT WEAKNESSES, STATE ACTIONS, AND PEARCE SUIT

THE BELL REPORT:

- LACK OF SUPPORT FOR CONCLUSIONS: A consistent problem throughout the Bell report is his failure to provide details in support of his assertions, so that the reader can verify them.

- "HARM TO BANKS EXAGGERATED": Bell asserts that estimates of restitution due, and thus harm to, the banks are exaggerated and that most of Hutton's banks were satisfied customers. He includes within this category of "satisfied" banks those that discovered the overdrafting and that demanded compensation. Obviously, our investigation shows that most of these banks were not satisfied and, in fact, many of them threatened to close Hutton's account if the overdrafting was not stopped. Bell says there were only a few banks that did not discover Hutton's activities, which we also dispute. Bell bases his claim that restitution estimates have been exaggerated on the small number of banks that applied for it by the deadline. He ignores the fact that many banks feel applying for restitution is futile, too time-consuming or expensive, and that many banks have already extracted compensation for their losses outside the restitution program.

- JUSTIFICATION FOR CHAINS: Bell claims that much of the chaining was "justifiable," in that it served the "legitimate" purposes of convenience and improving availability of funds. Presumably, Bell even considered chains set up to create float to be justifiable if one of these other purposes was also present.

- NUMBER OF CHAINS: DOJ indicated there were as many as 50 chains. Bell purports to investigate only 25, and makes conclusions about only 15. He does not disclose what happened to the other 10, or why he did not investigate the other 25. Using Bell's own appendices to the report, we identified 123 branches involved in a chain; in the report, however, Bell has apparently ignored his own appendices and explained the involvement of only 56.

o PLEA TO CERTAIN COUNTS A MISTAKE: Even though Hutton pleaded guilty to many counts involving the First National Bank of Louisville, Bell asserts that no fraud occurred because the bank was aware of Hutton's activities. In our conversations with the bank, it became clear that the bank discovered the overdrafting, demanded that it stop, and was promised that it would. After several months of unfulfilled promises, the bank threatened to close the account.

HIGHLIGHTS OF BELL REPORT WEAKNESSES, STATE ACTIONS, AND PEARCE SUIT 2

The Louisville branch manager asked the bank to write a letter to Bell, which Bell contends shows that the bank knew about and in essence consented to the activities. In fact, the letter only says that the bank knew about the activities, not that it consented. In context, the letter is extremely misleading. The branch manager suggested the letter's language to the bank; bank officials have told us that they would have been more complete if they had understood the context in which it was to be used.

o CONFLICTING WITNESS STATEMENTS: In a number of instances, Bell cites conflicts between statements of various Hutton employees, but either makes no attempt to resolve those conflicts, or resolves them without any explanation of how he reached his conclusions. Often, those resolutions are in favor of the higher level employee. Bell recommends sanctions against some of the branch and regional employees; ultimately, he must have concluded that the higher level employes who the branch and regional officers claimed approved their activities, but who denied it, were to be believed.

o THOROUGHNESS OF INVESTIGATION: Robert Fomon instructed Bell to take as much time as necessary to complete the investigation. Subsequently, however, Bell cut corners on the investigation and cut the investigation short. For example, he abandoned his announced intention to interview all relevant branch personnel before moving on to the regional level, and closed the investigation and moved to final judgment despite the fact that important information was available but not fully evaluated. This was apparently done in order to have the report available before federal and state regulatory bodies acted. While this is understandable, it would appear to have been better to also scale back the scope of his conclusions commensurate with the curtailment of the evidentiary phase. Perhaps the most fundamental flaw of the Hutton report is its exoneration of branches and personnel based solely upon their denials. (Noted and discussed elsewhere in this analysis.) It may be that this error could have been eliminated or reduced had Bell taken the time to complete the investigation, or scaled back his findings accordingly.

o INVESTIGATIVE CRITERIA: Excluding the branches identified in the Information counts, the investigative criteria used by Bell ultimately identified only one other branch -- Bakersfield, California -- where Bell found that excessive overdrafting occurred. Furthermore, Bell failed to find anyone responsible for those activities because the branch claimed the regional interest specialist instructed the branch to overdraft, the specialist declined to be interviewed, and other regional personnel contacted denied giving such instructions.

HIGHLIGHTS OF BELL REPORT WEAKNESSES, STATE ACTIONS, AND PEARCE SUIT 3

o EXONERATION OF BRANCHES: Twenty-eight offices, representing 168 counts and $123 million, were exonerated by Bell "[b]ased on the available financial documents and interviews of branch personnel...."

Fifty-five offices, representing 656 counts and $1.215 billion, were exonerated by Bell because "the personnel at these branches denied that they overdrafted in amounts greater than that required by the drawdown formula and worksheet." Bell concludes, "In the absence of evidence sufficient to establish that these branches engaged in excessive overdrafting ... they also should be exonerated." One of these branches -- Washington (Eye Street), D.C. -- was responsible for 97 counts and $436 million in transactions.

Ten offices -- 4 branches and 6 regions -- representing 176 counts and $623 million were not listed and dealt with in the Hutton report.

The Bell report, in discussing Perry Bacon's activities at the Alexandria branch, states, "Bacon admitted that the branch drew down 'not only deposits plus anticipated deposits, but also bogus deposits.' " Bell thus concluded that the Alexandria branch had engaged in wrongdoing. Bell failed to note that Bacon's statement was taken from a memo written by Bacon to fellow branch office manager Steve Bralove about their banking activities in Washington, D.C., not about the activities in Alexandria, Virginia. While his statement obviously expresses Bacon's belief about Hutton's firmwide policy, and other evidence, including Bacon's own admission before our Subcommittee, suggests that the statement was descriptive of his Alexandria practices, it is careless at best for Bell to so attribute the quote.

Furthermore, it is beyond belief that Bell exonerated the Washington, D.C. office. That office was responsible for 97 counts in the Information, and for overdraft checks totalling approximately $436 million, and the Bacon admissions relied upon by Bell were most specifically applicable to that office, rather than to Alexandria.

HIGHLIGHTS OF BELL REPORT WEAKNESSES, STATE ACTIONS, AND PEARCE SUIT 4

THE STATE PROCEEDINGS AND THE PEARCE SUIT:

We have obtained the orders of both Virginia and Georgia. We also know that New York has prohibited Hutton from engaging in remote disbursement. Just last week, Connecticut issued its findings, after holding extensive evidentiary hearings. The Bell report was relied on by Connecticut and was the basis for the Virginia and Georgia decisions. In short, Hutton is using both Bell and his report extensively in its negotiations with the states. Before any of the states acted, Bell and his team were invited to the annual meeting of the North American Security Administrators in Calgary, Canada and given a prominent role in the proceedings.

GEORGIA:

o According to the Georgia opinion, Georgia closely monitored and reviewed the progress, depth, and extent of the "independent investigation as to how the practices occurred."

o The Commissioner found that "the Bell investigation was an independent investigation, and that Hutton provided a clear written charter to create a process by which the investigation would be conducted."

o The Georgia opinion states, "According to the Bell report, no count in the Information was intended to be based upon the proper use of Hutton's drawdown work sheet." Therefore, it follows that Bell must have concluded that all counts must have represented improper usage. However, the order further states, "The Georgia branches did not engage in excessive overdrafting.

This finding is consistent with the Bell report, which exonerated each of Hutton's Georgia branches." Neither Bell nor the opinion mentions that count # 2000 of the Information represents a BRC deposited by the Atlanta branch into Citizens and Southern Bank.

VIRGINIA:

o Again, the Bell investigation and report formed the basis for Virginia's findings and order.

o Hutton agreed that five BOMs (excluding Bacon) cited by Bell would be removed from management and supervisory positions and that they would be: 1) restricted to sales activities for 60 months; 2) prohibited from acting in management and supervisory positions for 60 months; and 3) subjected to review of all transactions effected for 24 months. In addition, their customers will be questioned periodically by Hutton about how their accounts are being handled. Incidentally, none of the five BOMs worked in Virginia, yet Hutton was permitted to "trade" them for its license.

o In particular, Hutton is to formally indicate to the Commission that Perry Bacon was permitted to resign on account of his activities that, in part, resulted in the plea agreement.

CONNECTICUT:

o Branch Manager Robert Clark had his broker-dealer license suspended for six months.

o Hutton paid a $350,000 fine to the State; $150,000 to cover the costs of its investigation and the rest to be donated to Connecticut charities.

o Hutton is prohibited from signing up new customers in Connecticut for two weeks, beginning February 18, and is on probation for one year.

o Hutton must write letters of censure to its officials who did not properly supervise its cash management operations.

o Hutton must tell its Connecticut customers that they can receive payments with local checks.

JOHN PEARCE V. E.F. HUTTON AND GRIFFIN BELL:

Pearce charges in his suit that the Bell report contains the following false statements:

o Pearce engaged in the practice of chaining, and the practice was a "deviation from Hutton's normal drawdown structure."

o Pearce was responsible for creating a "St.Louis/Bethesda/Seattle chain."

o Pearce was responsible for creating the "only chain identified that was initiated and administered at the branch and not at the regional level."

o Pearce acted in such a manner that "no reasonable person could have believed that this conduct was proper."

o Pearce "actually engaged in wrongdoing."

o Pearce was a "moving force in improprieties."

o Pearce engaged in activity "so aggressive and egregious as to warrant sanctions."

Pearce also claims that Bell made these and other false statements at the press conference he held in Washington when he released his report.

ANALYSIS OF "THE HUTTON REPORT"

THE HUTTON REPORT: Results of the Investigation of the Regions and Branches where the Transactions to which Hutton Pleaded Guilty Occurred

The investigation used various criteria and analyses to identify branches that possibly engaged in excessive overdrafting and chaining. Furthermore, because branches in each domestic region were identified for investigation of excessive overdrafting, each region was investigated for this abuse also. The results, when related to the 1900 counts to which Hutton pleaded guilty, raise more questions--especially about the investigation--than they answer.

> **COMMENT:** Excluding the branches identified in the Information counts to which Hutton pleaded guilty, the investigative criteria used by Bell ultimately identified only one branch--Bakersfield, California--where Bell found that excessive overdrafting occurred. Furthermore, Bell failed to find anyone responsible because the branch claimed the Regional Interest Specialist instructed the branch to overdraft, the Specialist declined to be interviewed, and other regional personnel contacted denied giving such instructions.
>
> Additionally, the Information identified 113 offices that engaged in excessive overdrafting to which Hutton pleaded guilty. Bell failed not only to find someone responsible at 93 of these offices, he even failed to find excessive overdrafting.
>
> Twenty-eight (28) offices representing 168 counts and $128 million were exonerated by Bell "[b]ased on the available financial documents and interviews of branch personnel. . . ."
>
> Fifty-five (55) offices representing 656 counts and $1.215 billion were exonerated by Bell because "the personnel at these branches denied that they overdrafted in amounts greater than that required by the drawdown formula and worksheet. In the absence of evidence sufficient to establish that these branches engaged in excessive overdrafting . . . they also should be exonerated." One of these branches--Washington (Eye Street), D.C.--was responsible for ninety-seven (97) counts and $436 million in transactions.
>
> Ten (10) offices--four (4) branches and six (6) regions--representing 176 counts and $623 million were not identified in the Hutton Report.
>
> See chart *infra.*

THE HUTTON REPORT: Should Hutton have pleaded guilty to all counts of the Information?

Bell asserts that

> [i]n late fall of 1981 [Bill] Wilcox [the Louisville branch manager] negotiated a minimum fee service agreement with the First National Bank of Louisville. The bank closely analyzed the account and was fully aware of its status from that time until today. App. Exhibit 18 [attached]. This information raises serious questions about whether Hutton should have pleaded guilty to all counts of the Information. The government's theory of the prosecution of Hutton was that Hutton's abusive practices was [sic] a fraud on banks. In the case of Louisville, there obviously was no fraud (p. 71, n. 39).

COMMENT: We have spoken with executives from the First National Bank of Louisville. They told us, first, that Hutton began overdrafting its account almost immediately after it was opened in September 1981. The bank discovered the overdrafting and promptly asked Wilcox to stop. Wilcox agreed, but the overdrafting continued and in fact increased in amount. Finally, bank representatives had to contact Tom Morley in New York, who also promised that it would stop. It continued until the bank threatened to close the account. The bank also demanded financial compensation for the overdrafting. Finally, in March of 1982, the overdrafting ceased. The bank was paid $21,737.69 in service charges and compensation.

The Louisville bank representatives assert that they never agreed to let Hutton overdraft its account, and that they believe it is an unsound banking practice. They could perhaps be described as "acquiescing" in the overdrafting until Hutton stopped it. This was because Hutton had promised to accede to the bank's demand to cease the overdrafting immediately, and the bank was simply waiting for the "problem" to be straightened out. As noted above, when it was not, the bank threatened to close the account. Bell's assertion that there was no "fraud" on the Louisville bank because a minimum service fee requirement was negotiated in the late fall is misleading at best. The bank "negotiated" this arrangement in an attempt to compensate itself for the overdrafting.

They were asked to write the attached letter by Bill Wilcox, who drafted it for them. They were not aware of the context in which the letter they wrote would be used, and would have made it more complete had they known.

THE HUTTON REPORT: The number of chains

On page 38, Bell states that the Department of Justice identified 25 chains in its presentation to the court when Hutton pleaded guilty. In footnote 19, he notes that the Department "has stated that as many as 50 chains existed. The scope of our investigation does not permit us to confirm or dispute this claim." On page 56, Bell identifies the chains according to the categories listed above. He finds that 7 of the chains were created to generate clearing delays (category 1), but of this number, 2 were also motivated by the desire to improve availability of funds (category 2); 6 chains were created to improve availability of funds (category 2), including the 2 referred to above; and 4 chains were created for convenience purposes (category 3). Thus 10 chains were "justifiable," according to Bell's analysis, and 5 were not.

COMMENT: First, why does Bell assert that DOJ's "claim" that there were as many as 50 chains is beyond the scope of his investigation? Surely, the extent of the chaining is critical to a complete investigation.

Second, Bell purports to review only the 25 chains identified by DOJ at the plea proceeding, but does not even do this. The number of chains he categorizes is only 15. There is no explanation anywhere of the other 10 chains.

Third, as noted above, does dual motivation make a chain "justifiable?"

Bell used a number of criteria to identify branches to be interviewed or investigated on the subject of chaining.

> The chains identified by the Department of Justice during the plea-taking on May 2, 1985, and those identified by Hutton's outside counsel and internal auditors were used to identify branches to be interviewed (p. 37).

COMMENT: The Justice Department identified twenty-five (25) chains and indicated there may have been as many as fifty (50); using appendix 9 and appendix 12, we have found 23 branches identified as being in a chain by Hutton's outside counsel, the Department of Justice, or Hutton's internal auditors. Of the 123 branches identified, Bell has discussed the activities of only 56, fewer than half. There is no indication about whether or not these branches were "interviewed."

HUTTON REPORT: Resolution of conflicting statements of witnesses

COMMENT: In a number of instances, Bell cites conflicts between statements of various Hutton employees, but either makes no attempt to resolve those conflicts, or resolves them without any explanation of how he reached his conclusions. Often, those resolutions are in favor of the higher level employee. Bell recommends sanctions against some of the branch and regional employees; ultimately, he must have concluded that the higher level employees who the branch and regional officers claimed approved their activities, but who denied it, were to be believed.

The following are examples:

1) Bell says that Aaron Hickey, the south central region's Interest Specialist, "established chains for the expressed purpose of creating clearing delays (p. 53)." "Hickey stated that Morley, Hutton's Money Mobilizer, said that chaining was permissible. Morley denied this (p. 53, n. 29)." Bell does not attempt to resolve the inconsistency.

2) John Pearce, the Bethesda, and then St. Louis, branch manager, "claims that the St. Louis/Bethesda drawdown was approved by Michael Wallace, the Central Regional Operations Manager. Wallace denies this assertion (p. 58)." No attempt is made to resolve the inconsistency.

3) Aaron Hickey "claims that Morley authorized him to increase the dollar amount of the calculated drawdown" in the South Central region. "Morley denies this (p. 60)." The inconsistency is not resolved.

4) Three midwest region branches, Grand Rapids, Michigan, Milwaukee, Wisconsin, and Minneapolis, Minnesota, claimed that the region instructed them to engage in excessive overdrafting. Michael Goldstein, the midwest region's Operations Manager, denied this (p. 65). The inconsistency is not resolved, although Bell did include this discussion under the category "Excessive overdrafting that was directed, approved, or supervised by the region."

5) The Bakersfield, California branch claimed that Mark Willets, the Regional Interest Specialist, instructed the branch to engage in excessive overdrafting. Willets declined to be interviewed (p. 65). Although the inconsistency is not resolved, this discussion is included in the same category as # 4 above.

6) The Fresno, California branch manager, William Shaw, engaged in excessive overdrafting, claiming that the region approved the amount of the drawdowns. "The region" denied this (p. 71). Bell does not even state who in the region he spoke to. This discussion is included under the category "Excessive overdrafting directed by branch personnel."

7) Richard Genin, then Senior Vice President for Trading Operations, "disclaims any responsibilities for cash management and contends that this was the Money Mobilizer's area of control and supervision. Morley places Genin at a meeting in early December of 1981, after a weekly operations meeting at which Jensen and Morley told Epstein that there had been a problem with the Genessee Bank caused by overdrafting. Genin does not remember being there, and [Art] Jensen [the Atlantic Region Operations Manager] cannot remember Genin being there." The inconsistency is not resolved.

8) Perry Bacon, branch manager for the Alexandria and one of the Washington, D.C. offices, claims that Genin asked him how he made such large interest profits, that he explained his excessive overdrafting practices, and that Genin told Bacon he saw nothing wrong with those practices. Genin denies the incident (p. 89). The inconsistency is not resolved.

9) Tom Lillis, Vice President of Accounting Services, wrote a memo stating that a good cashier was worth as much as a good account executive in terms of generating interest income. Lillis says that the memo was a response to an inquiry by Robert Clark, the Hartford branch manager. Clark does not recall the request. "Later it developed that the Hartford office was engaged in serious overdrafting (p. 91)." Bell does not resolve the inconsistency.

10) Goldstein and Hickey "claim that their aggressive cash management practices were approved by personnel in the money management section in New York, New York. The head of this section [presumably Morley] has denied this claim. While approval from superiors can mitigate, it should not be allowed to exonerate these employees (p. 181)." Whether someone at corporate headquarters in fact approved the activities at issue here should have been a pivotal question of Bell's investigation. Ultimately, it is a question he never adequately resolves. Arguably, Bell implicitly concludes that the behavior of the regional employees was worse than that of the New York officials, given their respective punishments.

Bell recommended that Pearce, Bacon, and Shaw be fined a minimum of $25,000 and a maximum of $50,000, be assessed a proportional share of the restitution payment, be placed on company probation for a year, and receive letters of reprimand. He recommended that Hickey, Jensen, and Goldstein be suspended without pay for 30 days, and that they receive letters of reprimand (p. 179-81).

Morley, he recommended, should "be removed from any responsibility connected with money management or banking. We do not suggest that Morley be discharged because his defalcations was [sic] more than just *his* defalcations; they were a part of a failing in a management system (p. 175)."

Mark Willets no longer works for Hutton.

Genin was recommended for a letter of reprimand for failing in his responsibility to supervise the Regional Operations Managers who reported to him (p. 176).

No recommendation was made regarding Lillis.

THE HUTTON REPORT: Scope of the Investigation

CEO Robert Fomon, in a letter to Bell dated May 28, 1985, set forth the scope of Bell's retention as follows:

> You are hereby requested to review the practices to which the Company pleaded, determine how those practices evolved, identify those individuals who bear personal responsibility (officers and employees) and make recommendations with respect to these individuals. . .
>
> It is our hope that you will proceed as expeditiously as possible, but take as long as is required thoroughly to complete your investigation. I pledge to you our full resources and cooperation and am directing all officers and employees to do the same. . . .

Bell, in various places in his report, described the scope of the investigation as follows:

> (1) The Justice Department investigation covered the period from 1980 through 1982, and our investigation focused on conduct that occurred during this period (p.4).
>
>> COMMENT: The Justice Department investigation covered the period January 1, 1979 through April 1, 1984, and possibly later.
>
> (2) The document review phase of our investigation was necessarily limited to the documents we received. We had no subpoena power or other mechanism to ensure access to all documents that may be relevant to the matters discussed in this report. We are not aware of any instance in which Hutton refused to provide relevant documents, with the exception of certain documents that Hutton and its counsel considered privileged. . .
>
> Hutton apparently failed to retain copies of certain documents produced by Hutton to the Department of Justice in the early phase of the grand jury investigation. These documents were not made available to us at all until August 30, 1985. Since that time, we have received copies of a limited number of these documents, and we have reviewed those that we have received (p.7).
>
>> **COMMENT:** Hutton's claim of privilege apparently was applied selectively against Bell, because Bell received documents on which Hutton is claiming privilege against the Subcommittee.
>
> (3) It was not possible . . . in the time allotted for the investigation to interview all relevant branches before commencing interviews at the regional level (p. 35).
>
>> **COMMENT:** Fomon directed Bell to "take as long as is required. . . ."
>
> (4) Our investigation of branches was limited to an inquiry into the conduct that gave rise to Hutton's guilty plea (i.e., chaining and excessive overdrafting), and our interviews were restricted to personnel employed during the relevant time at those branches that were

either (1) identified as a branch suspected of having been involved in a chain, or (2) identified as a branch suspected of having engaged in excessive overdrafting (p. 36).

> **COMMENT:** Apparently Bell did not look at the practices for which Hutton was enjoined.

(5) The Department of Justice has stated that as many as 50 chains existed. The scope of our investigation does not permit us to confirm or dispute this claim. We did investigate a sufficient number of branches to reach valid conclusions concerning the purpose of chaining and who was responsible for it (p. 38).

> **COMMENT:** To what limitation or scope does this refer? Without establishing the universe, his sampling is invalid.

(6) Ledgers listing Chemical Bank BRCs used during the period between May 22, 1981 through November 30, 1981 were not available to us on a timely basis (p. 42).

> **COMMENT:** Bell prepared his report without key information about a critical period.

(7) A significant portion of the branch financial documents that we requested were in the possession of the Department of Justice in Harrisburg, Pennsylvania, and were therefore not available for our use at the time of the interviews. Although branch personnel generally recalled and admitted their activities with regard to chaining, recollection with regard to excessive overdrafting was less vivid, even at branches suspected of this activity. The unavailability of all of the relevant branch financial documents, therefore, hindered our investigation into excessive overdrafting (p. 46).

> **COMMENT:** This lack of documentation apparently did not, however, hinder Bell's rendering of his findings.

(8) Although the remaining sixty-nine (69) branches were identified as having possibly engaged in excessive overdrafting, the personnel at these branches denied that they overdrafted in amounts greater than that required by the drawdown formula and worksheet. In the absence of evidence sufficient to establish that these branches engaged in excessive overdrafting, we conclude that they also should be exonerated (p. 72).

> **COMMENT:** Fifty-five (55) of these sixty-nine (69) branches were represented in the 2000 counts to which Hutton pleaded guilty; the number of counts for each of these offices ranged from one (1) to ninety-seven (97) and the dollars ranged from $50,000 to $437,000,000. One office, Kansas City, met all eight (8) of Bell's criteria for having engaged in excessive overdrafting.

THE HUTTON REPORT: The effect of excessive overdrafts on banks

Bell asserts that the estimates of restitution due the banks are exaggerated and that the Justice Department's "presumption that Hutton's banks were unwary victims is in many cases incorrect."

Bell classifies the victim banks into four groups. First, there were banks

> at which Hutton's deposit account was maintained in a manner satisfactory to the bank, both in terms

> of available funds overdrafts and bank compensation. This group includes those banks at which no excessive or consistent available funds overdrafts occurred. It also includes those banks at which available funds overdrafts were detected, either 1) on a daily basis or 2) during or at the end of a compensation period, and for which additional compensation was requested (p.127-8).

Bell asserts that "most banks with which Hutton maintained account relationships during 1980 to 1982 appear to fall into the foregoing group of satisfied banks."

> **COMMENT:** First, Bell does not identify those banks at which he alleges "no excessive or consistent available funds overdrafts occurred." Thus, there is no way to check how many such banks there were. Second, to denominate as "satisfied" those banks that discovered the excessive overdrafting and that extracted additional compensation from Hutton is inaccurate, to say the least. This would include banks such as the Genessee Country Bank in Batavia, NY and the United Penn Bank in Wilkes Barre, PA, both of which required Hutton to leave funds on deposit to compensate for the overdrafting. United Penn also received a $5000 compensating payment from Hutton. Both banks then closed Hutton's account. Bell would also include as a "satisfied" bank the First National Bank of Louisville, discussed infra. Even those banks that did not close Hutton's account but where Hutton engaged in excessive overdrafting can hardly be considered "satisfied." Many, many banks sought for weeks and sometimes months to force Hutton to stop this activity, often threatening to close the account until Hutton finally capitulated. Bell's failure to distinguish between these banks and those that were truly "satisfied" (if indeed there were any) substantially undermines the credibility of his analysis.

Bell's second category is "banks that failed to detect either daily or consistent available funds overdrafts in Hutton's deposit account. This includes banks that could not make such determinations or, for whatever reason, did not. Bell concludes that few banks fall into this category.

> **COMMENT:** Bell fails to distinguish between "available" and "collected" funds. This is an important distinction, because Hutton sought situations where availability was the same or better than collectibility. While banks sometimes make funds available to the depositors whether or not those funds have been collected, it is the ability to determine the collected balances that enables banks to protect themselves against overdrafting or drawing on uncollected funds. Moreover, Bell ignores the fact that Hutton deliberately opened accounts in banks that it believed did not have the technical sophistication to determine collected balances. Again, he fails to identify these banks, precluding the reader from checking his assertion.

Bell's third category includes banks that did have the ability to determine available balances (see discussion above), but that did so inaccurately. He identifies at least one bank falls into this category, but no more than a "very few."

> **COMMENT:** Again, Bell's failure to identify these banks precludes the reader from checking his analysis. In addition, Bell creates an entire category consisting of one bank that apparently made an error in determining its balances and he seemingly blames that bank for Hutton's activities.

Bell's fourth category "would include banks that knew of consistent available funds overdrafts in Hutton's deposit accounts and tolerated those overdrafts without complaint (p. 130)." However, Bell is aware of no bank that would fall into this category.

> **COMMENT:** Again, Bell provides no details to support his assertion, precluding the reader from verifying it.

THE HUTTON REPORT: Bank restitution program

Bell concludes that because only 26 banks had applied for restitution by the August 28 deadline, and an additional 74 notified Hutton of their intent to do so, "injury to the banks has been overestimated."

> **COMMENT:** Bell acknowledges that "a few banks are reluctant to assert claims in part because of the time and expense required to review or recreate records of transactions that occurred five years ago and in part because of a fear of possible adverse local or national publicity if the bank discovered that it had a claim against Hutton (p. 131, n. 100)." Again, Bell does not identify these banks, making verification of his claim, and of the number of such banks, impossible. Our indications are that there are quite a few such banks.
>
> Bell does not discuss the other options (such as a civil RICO suit, or other civil litigation) that banks might be pursuing in lieu of a claim for restitution. Neither does he acknowledge that some banks are dissatisfied with the terms of the restitution plan. First, it places the burden of analyzing the records and proving their damages on the injured banks, rather than on Hutton. Second, the plan requires the banks to offset any collected balances from July 1, 1980 through December 31, 1982 against any uncollected balances during that period. The criminal charges cover only the period from July 1, 1980 through February 28, 1982. Hutton allegedly stopped the illegal activities in early 1982, and began leaving large collected balances on deposit. By including the extra period of time between February 28 and December 31, 1982 in the restitution plan, the amount of the banks' damages is diluted.

THE HUTTON REPORT: The report is in the nature of a "public inquiry."

On page 3, Bell asserts that because Hutton decided to release the report to the SEC, the 50 state securities commissioners, the Congress, and the public, it "changed the investigation from an inquiry by Special Counsel at the request of the Board of Directors into something that would reasonably be considered a public inquiry."

> **COMMENT:** No one asked Hutton to retain Bell to write this report, and Hutton's decision to release it to the public does not obviate the fact that Hutton paid for the report and that Bell is Hutton's, not the public's, counsel.
>
> In addition, the Subcommittee requested supporting documents that Bell did not make public. The request was denied on the basis that the documents are "privileged." This is inconsistent with Bell's claims that his report is public.

THE HUTTON REPORT: "Due process" hearings

Bell claims that he conducted "interviews in the nature of due process hearings" with "individuals who bore some responsibility for the Hutton problem (p. 5)."

> **COMMENT:** Did Bell advise these people of their rights? Will their statements be turned over to the government if they show evidence of perjury or obstruction of justice?

Bell does not provide any description of the kind of "due process" he provided. Since Bell is no longer a judge or Attorney General, it is presumptuous, to say the least, to say that his inquiry was conducted according to "due process" standards.

THE HUTTON REPORT: Was "chaining" ever "justifiable"?

Bell asserts that

> there were three purposes for chaining: (1) to generate clearing delays and thus increase interest profits by obtaining one day availability and two-day clearance on BRCs and DTCs; (2) to improve availability of funds; and (3) convenience. In our opinion, the latter two chaining purposes were justifiable from a business standpoint (p. 55).

> **COMMENT:** Bell does not even discuss how he arrived at this conclusion. He does not consider whether Hutton might have had a combination of motives for setting up the chains. For example, if Hutton's primary motivation was category one, to create float, but a secondary motivation was category three, convenience, Bell's criteria would apparently render this chain "justifiable." In addition, if the banks were unaware that they were part of a chain and/or were harmed by the activity, Hutton's motivation for it may be irrelevant.

THE HUTTON REPORT: Who is entitled to the "float"?

On page 21, Bell asserts that

> [f]rom Hutton's perspective, someone other than Hutton has use of Hutton's funds during the period between the time Hutton deposits checks into its local bank accounts and the time the funds represented by those checks are made available to Hutton . . . Hutton, not unlike other corporate depositors, believes that it is entitled to share in the value of those funds while they remain in the process of collection in the payments systems.

> **COMMENT:** Bell says here that Hutton believes it is entitled to the benefits of the float on customer funds from the time customer checks are deposited into Hutton's account. Not even Hutton has made this assertion. If the float ever "belongs" to anyone, at that time it "belongs" to the customer, until the check clears and the funds become Hutton's.

THE HUTTON REPORT: Hutton's branch ledger balance

On page 31, Bell says that if the drawdown sheet operated "as designed," at the close of the business day, the branch office's ledger balance "would always be negative."

> **COMMENT:** This is not true in all cases. For example, if the branch did not have a deposit of customer receipts of good funds on a particular day, the ledger balance should be zero. A deposit late in the day after the branch has notified the region of the amount to be drawn down will result in a positive balance. Obviously, a correct understanding of the results obtained through use of the drawdown sheet is key to an adequate analysis of Hutton's activities.

THE HUTTON REPORT: Recommendations

On page 16, Hall makes his final recommendations. The fifth recommendation is that "Hutton employ its independent accountants to review the adequacy of Hutton's system of internal accounting controls relating to the cash concentration system."

COMMENT: This kind of review is supposed to be at the [illegible] of any thorough financial audit. It is remarkable that Arthur Andersen has not conducted such reviews in the past, or at least assured that Hutton's internal audit department did so before AA signed off on the financial statements.

ANALYSIS OF "THE HUTTON REPORT," page 1[illegible]

COMPARISON OF INVESTIGATIVE RESULTS WITH PROSECUTORIAL RESULTS

The investigative results as set forth in the Hutton Report are compared with the prosecutorial results as reflected in the 2000 counts included in the information and to which Hutton "pleaded guilty" in the following table:

Hutton Report Results Category	Number of Offices	Prosecutorial Results Number of Offices	Number of Transactions	Approximate Amount
Regional Offices				
[illegible] overdrafting (only in the South Central Region)	1	1	74	$346,000,000
Other	None	6	563	613,000,000
Branches				
[illegible]	10[illegible]	None	--	--
[illegible]	[illegible]	6*	[illegible]*	[illegible]
[illegible]	4	[illegible]	1[illegible]	128,000,000
[illegible]	[illegible]	55	65[illegible]	1,215,000,000
[illegible]	[illegible]	14	[illegible]	1,919,000,000
[illegible]	--	2	11	10,000,000
	[illegible]	11[illegible]	[illegible]	[illegible]

* [illegible]

FIRST NATIONAL BANK
OF LOUISVILLE

First National Tower Louisville Kentucky 40202 Telephone (502) 581-4151

JERRY W. JOHNSTON
Senior Vice President & Director
of National Banking Division

August 30, 1985

The Honorable Griffin B. Bell
2500 Trust Co. Tower
Atlanta, Georgia 30303

Dear Judge Bell:

This letter will acknowledge that in the late fall of 1981 we negotiated our minimum service requirement fee with Bill Wilcox at the Louisville office of E. F. Hutton and that our monthly analysis has kept us fully aware of the status of their account from that time to the present.

Sincerely,

Jerry W. Johnston

Jerry W. Johnston
Senior Vice President

JWJ:je

cc: Bill Wilcox

QUESTIONS FOR CONGRESSMAN WILLIAM MCCOLLUM

Question #1: E.F. Hutton apparently engaged in three kinds of overdrafting:

1. target balance overdrafting

2. gross overdrafting, and

3. chaining

The Department of Justice in its information charged that gross overdrafting and chaining violated the mail and wire fraud statutes, that is, that the practices constituted a "scheme to defraud", in which the mails and wire communications were employed.

In your judgment, how good a case did Justice have?

Question #2: Justice has suggested to us that it had a "representation" problem under Williams v. United States, 458 U.S. 279 (1982) and United States v. Frankel, 721 F.2d 917 (3rd Cir. 1983) and that the prosecution lacked jury appeal.

Do you agree?

Question #3: Could Justice have strengthened its hand by reconceptualizing the prosecution after Williams and Frankel as criminal "conversion" under 18 U.S.C. Section 2314?

Question #4: Would Justice have been in an even better position had it analyzed its prosecution under RICO (18 U.S.C. Section 1961 et. seq.)

Question #5: Did Justce follow the best procedure in handling the investigation so as to maximize its chance, not only of charging the corporation, but the responsible individuals?

Question #6: Would Justice have had a better shot at establishing high level responsibility had it indicted and convicted key middle level individuals and then sought to turn them before sentence, as it was done in the Watergate investigation?

Question #7: Overall, you think society or the victims were well-served by the results obtained in the Department of Justice in its investigation and prosecution of E.F. Hutton?

ANSWERS TO QUESTIONS

SUBMITTED BY THE HONORABLE JOSEPH BIDEN

Question #1

I believe there was no criminal case for target balancing activities. There was a case for chaining and excessive overdrafting, but I am not sure that it was a case that could be won. As a trial attorney with criminal law experience, I appreciate the complexity of this case and the difficulty of trying such a complex case of first impression before a jury.

Prosecutors should never prosecute a person for activity unless that activity is illegal. Target balancing was encouraged by the banks and used by many companies besides Hutton both in and outside of the investment field. There was no indication that the Justice Department or any other person previous to this case questioned the legality of target balancing. I believe that the prosecutors were correct in their analysis that such a common practice was not criminally fraudulent under mail and wire fraud statutes even though they believed, as I believe, that the activity was unethical and dangerous. However, the prosecutors' brilliant first use of the new civil injunction provision stopped this activity despite their inability to charge it criminally. The strength of the case, which I will address in a moment, must be considered in light of the much more wide spread conduct that could not be prohibited by a criminal trial, such as target balancing.

The prosecutors believed they had a case against the company and two mid-level Hutton people for violations of mail and wire fraud based on the arbitrary overdrafting and chaining. However, the prosecutors testified, and I have no reason to doubt their expert opinion, that a case on these issues would have taken one and one half years. After a year at the appellate level, the Supreme Court would probably have exercised jurisdiction over the case for an additional six months. The trial alone would have involved three hundred witnesses and several thousand documents. Every single check would have required the introduction of twenty pieces of proof. Issues such as jury sympathy for bankers who in some cases looked as guilty as Hutton must be considered. The prosecutorial resources spent on such a lengthy case tied to just two serious but narrow practices in my view would have been the result of poor judgement in light of the ability to obtain in the plea agreement an injuction of all serious practices, civil restitution, and a two million dollar fine.

The prosecutors testified that they had only a fifty-fifty chance of conviction of the corporation and no chance of convicting individuals. As you can see, the answer to your question is that they had a case. However, the question you did not ask must also be asked: Could they win? It is unlikely that the expensive, lengthy, narrow case would result in anything on balance that would be a victory to society.

Question #2

Since the banks were in many cases knowing victims, and Hutton's activities are perceived by many to be little more than what banks do to their customers, like you and me, every day, I must answer your question, yes, this case lacked jury appeal. Not only because of the activities of the victims, but also because of the complexity of the case and the fact that criminal charges would be against mid-level officials brought for activity that was not before illegal and no one was on notice that it would be considered illegal. Neither of the two individuals, for which evidence of criminal activity existed, got any personal economic gain from the criminal schemes.

The application of the mail and wire fraud statutes to the Hutton facts after Williams and Frankel is extremely difficult. A misrepresentation or a scheme to defraud must be proven without using the checks themselves as misrepresentations. This requirement was not possible in the case of target balancing since the banks were on notice of this activity and in many cases encouraged it. Other companies were actively engaged in target balancing, making it an industry wide practice.

The prosecutors found that Hutton misrepresented its purpose and use of customer deposit bank accounts when it began chaining and excessive overdrafting. Without this type of misrepresentation, mail and wire fraud violations were not provable.

Question #3

I have not studied the use of section 2314 of title 18 of the United States Code in great detail as an alternative to the mail and wire fraud statutes because such a choice of statutes is well within prosecutorial discretion and I view such an issue to be arm chair prosecuting, or Monday morning quarterbacking. Since you asked, however, I do not perceive how you can have a "conversion" without a fraud on the banks in the Hutton case. Proving a fraud puts the prosecutors in the same position in your suggested statute as they found themselves when they relied on mail and wire fraud. Thus, in my view, use of 18 U.S.C. §2314 provides a distinction without a difference. The use of this statute does nothing to solve the problems associated with lack of jury appeal.

Question #4

The prosecutors considered and rejected prosecution under RICO. Since this statute is one of enhanced penalties rather than a substantive offense, I do not perceive how it would have strengthened the case against Hutton. Perhaps you are suggesting that the prosecutors would have had more power at the bargaining table had they used RICO. The prosecutors' main goal appears to have been to stop the various cash concentration practices, including target balancing, and this was possible only in the context of a plea agreement incorporating a civil injunction.

The Hutton attorneys made the prosecution of individuals a "deal breaker". In other words, no plea bargain was possible unless an agreement was reached prohibiting individual prosecution for reasons other than perjury (testimony before our Subcommittee indicates that use of this "deal breaker" by Hutton counsel was done without Mr. Fomon's knowledge although this fact was unknown to the prosecutors). Use of RICO as a bigger club in the hands of the prosecutors probably would not have altered the reliance of the Hutton counsel on their "deal breaker." However, such analysis is mere speculation; we were not there, we cannot read the minds of the Hutton counsel. RICO did not affect the first use of the new bank fraud civil injunction, which I believe is the cornerstone of the Hutton resolution.

I am enclosing an article from a recent edition of the New York Law Journal, which is extremely critical of the prosecutors for over aggressiveness in their negotiations with Hutton. Although I disagree with the views in this article, I think it makes the point that the biggest and worst punishment possible is not always in the best interest of the public. For example, the $2 million fine is the result of 2000 counts of wire and mail fraud. The postal inspectors established around 3500 counts before they simply stopped counting. Technically, in spite of the small fines available under these statutes the prosecutors could have had fines so high as to put Hutton in financial jeopardy.

I guess if RICO had been used the government could have forfeited Hutton branch offices used in the chaining and arbitrary overdrafting schemes. Theoretically, the prosecutors could have put Hutton out of business and the 17,000 Hutton employees on the unemployment roles. I do not think either you or I would advocate such an extreme. The point I make is that prosecutorial judgement is used to make a cut off point, and even if we disagree with their established point we should not be second guessing such a decision unless it is beyond the lines of ethical conduct or the result of political influence. I see none of these improper activities in this case.

Question #5

I have no criticism of the manner in which this case was handled either by the local prosecutor or his superiors. If the local prosecutor had not dedicated himself to this case in a manner way beyond the call of duty or professional expectations, this case would never have been brought at all. No one can in good faith argue with this statement.

You should be aware of two other excellent factors in this case. First, the secrecy maintained during this investigation is an example of the professionalism of all of the prosecutors and investigators who participated in it. Finally, in order to bring this case, the investigators developed their own computer programs to trace the movement of money throughout the Hutton cash concentration schemes. These computer programs were more complex and detailed than anything similar to them. The needs of this investigation were beyond the developments of similar programs by the FBI, SEC, and Federal Reserve to which the investigators first went for help.

Question #6

The answer to your question is yes only if you believe that low level officials perjured themselves during grand jury testimony when they failed to implicate high-level Hutton officials as participants in the chaining and overdrafting schemes. The prosecutors did not have this kind of evidence. Rather, the information suggests that the high-level officials knew of target balancing but not chaining and arbitrary overdrafting. The various regions and branches were at the heart of the mutations called chaining and arbitrary overdrafting, which were perceived by most of those involved to be consistent with the aggressive company policy. Few persons carrying out these schemes had the necessary criminal intent.

The prosecutors had the grand jury testimony of low-level, mid-level and high-level officials, which did not point higher than two mid-level Hutton individuals. Unless you suggest that many of these people perjured themselves, your alternative trail strategy would not make any difference. Remember too that few of the people participating in the scheme had an understanding of its criminal nature. Only these few could be ethically charged under the strategy you suggest, and the prosecutors believed that they had only a 50-50 chance of winning a case against mid-level employees. Thus, I would not endorse your alternative strategy.

Question #7

The heart of the success of this case lies in its purpose, which was to protect the public. The key to obtaining this goal is the civil injunction. Chaining and excessive overdrafting posed a serious criminal risk to the banking industry and all persons relying upon it. When you take into account the impact of the various schemes on the banking system in general, however, you will also note the extreme danger posed by target balancing. This activity, albeit not a violation of mail or wire fraud, put the security of the banking community at risk because it was even more than an industry wide practice.

Federal Reserve Board Chairman, Paul Volker testified before the House Banking Committee that the Hutton plea agreement is one explanation for the one billion dollar surge in the money supply last summer. This is just one indication of how wide spread the target balancing had become. The injuction stopped this activity and put businesses on notice that target balancing would be considered a violation of the new bank fraud statute henceforth.

The American public did not pay for the investigation, Hutton did, and the largest fine in the history of white collar prosecution was added to the general treasury. The first nation wide restitution program was instituted, and I believe signifies an important trend that places the victims' interests up front instead of at the back of the line.

A trial would have been geographically restrictive due to the venue restrictions in federal court. Only activities within the middle district of Pennsylvania could nave been charged. The impact of this restriction on the fine, restitution, and other aspects of the case could not have served the American public to the extent that was achieved in the plea agreement. Giving up the civil injuction and restitution to attempt a very risky trial of two mid-level officials would not have been a decision I would consider to be in the best interest of the people. It may have reflected self-interest or self-promotion on the part of the prosecutors.

The public would be well served if Congress would react to the Hutton case by correcting the flaws in the banking system, which permitted the evolution of this fraud. The public is not served when their faith in the criminal justice system is challenged by media hype promoting the incorrect notion that rich people with the right connections do not have to go to jail for their criminal activities. This suggestion is not supported by the facts in this Hutton investigation and is in direct conflict with the extreme dedication to this case by non political prosecutors and investigators over a four year period. Their motivation was to protect the unwitting public from activity that they perceived to pose serious financial risk.

That they did their best, which I believe was an exemplary job, is what the public expects and deserves. You or I might have done things differently, but that is not the point. I venture to say that there is not one piece of legislation that either you or I have ever promoted which is above criticism from some vantage point in either its text or the manner in which it is processed even though we did our best. Perhaps we are fortunate that our work is not scrutinized in such detail after the fact.

The public was well served by the dedication and performance of these public servants.

ADDITIONAL MATERIAL THAT GOES WITH QUESTION 4

NY Law Journal
5/06/86

Bluff — An Indefensible Stratagem by a Prosecutor

By Stanley S. Arkin

Like much in life, as was suggested in a recent *Wall Street Journal* article, "[b]luffs, harried negotiations and plain luck often determine the outcome of complex white collar crime prosecutions."[1]

The article reported that E. F. Hutton, in its now famous overdraft case, was in effect bluffed by the Government into pleading to 2,000 felony counts when, bottom line, the Government would have been happy to have had a single felony count, as it had qualms about the "soundness of some legal theories central to the case." The vagaries of luck are part of the human condition and harried negotiations are bound to take place in the resolution of almost any meaningful dispute. However, it is worth some comment that there are cases, and more than a few, where a government bluff may, and in my view does, affect the outcome of serious criminal prosecutions.

Our justice system is an adversarial one which, while it goes some distance toward insuring against arbitrariness and oppressiveness, may nonetheless camouflage or even purport to justify inexcusable conduct or out-and-out savagery. In civil cases between private litigants, poker playing may have its place. Yet with the present system of civil discovery being what it is, the capacity for grave injustice occasioned by bluff is minimized. (Even in such situations, however, there is an outer limit to the lack of candor which an attorney may employ.[2])

Liberty at Stake?

In criminal cases, bluff involving a less than sincere articulation by the government of its legal and factual view of the case raises a profoundly different spectre than in civil cases. Personal liberty may be at stake and, in any event, what is at issue is usually apt to be far more portent than mere money damages.

Of course, prosecutors are subject to the same canons and duties as other lawyers. Yet, the relative dearth of discovery in the criminal process, particularly in the pre-indictment stages, means there is a great deal less check on the candor or forthrightness of a prosecutor. So much more is dependent upon the good faith and decency of the government officials involved.

That many prosecutors or Justice Department officials are in the early stages of their careers where ambition may affect judgments is not a helpful circumstance. Similarly, political aspirations or desire for ego-massaging publicity, not an uncommon affliction of supervising prosecutors, is hardly calculated to breed moderation or forbearance or even bottom-line fairness. The aggressions occasioned by ambition (or greater hormonal output of the younger government lawyers) do have positive consequences for society — the vigorous prosecution of bad people for bad acts. But in the area of bluff — as was apparently the case in E. F. Hutton, which I suggest is not a singular occurrence — there is a danger of grave injustice.

In the criminal sphere, the risks of calling the prosecutor's bluff are horrifying. The existence of the RICO statute, for example — which has the capacity of raising what would otherwise be a simple mail fraud or even a commercial bribery into the most serious of federal felonies — may simply be too much to chance.

Recently, I was involved in a matter where, with what appeared to be minimal basis for prosecution in a particular federal jurisdiction and only the most banal of criminal conduct, the prosecutor threatened to concoct a RICO case unless the company and officers all immediately pleaded to federal felonies. It was patently clear to me that there was a lot of bluff in what the prosecutor was doing, but the risks of a RICO indictment were enormous. Only the advent of an unusual circumstance obviated negotiations or the necessity of calling the bluff by going to trial, and permitted us to dispose of the matter by civil settlement. That was luck.

Duty to Be Fair

What seems to be forgotten too often is that prosecutors — at least at the stage where decisions are being made whether or in respect to what to prosecute — are quasi-judicial officials.[3] What this means is that there is an overriding — almost fiduciary — obligation to be fair. I am not suggesting a prosecutor has to show his or her full hand, but doubts about the factual adequacy or legal theory or jurisdiction in a case should not be hidden in the hopes of bluffing somebody who might not otherwise be convicted into a plea arrangement, or into entering a plea harsher than otherwise would be accepted.

What place does unfettered poker playing have in the process? I suggest none. The prosecutor is in fact a magistrate. The obligation to do justice must rest squarely on the facts and law as they are, and not on what the prosecutor might wish them to be.

It is not easy to protect against the sort of abuse which appeared to have taken place in the E. F. Hutton case. Open discovery in the pre-indictment stages is simply not going to happen and, in any event, may well be violative of rules protecting grand jury secrecy.

It may be too much to ask that a United States Attorney or a County District Attorney invest his or her assistants with a magisterial attitude. After all, prosecuting does have a little bit of the sporting atmosphere about it, at least in certain jurisdictions, and scores are kept, though, perhaps, not spoken about openly. Possibly, sure and definite Justice Department guidelines and effective internal review procedures would protect against this kind of overreaching on the part of prosecutors.

But there is little hope of devising much in the way of a formal solution to the problem. Ultimately, we are left to rely largely upon the decency of individual prosecutors and their chiefs.

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(1) "Hutton Overdrafting Case Was Settled Only After Some Miscues On Both Sides," *The Wall Street Journal*, April 9, 1986.

(2) See Code of Professional Responsibility, DR 7-102.

(3) See, e.g., *People v. Heller*, 120 Misc. 2d 85 (Sup. Ct. Kings Co. 1983); *ABA Prosecution Standards*, §3.3(3).

Senator BIDEN. Well, let me ask you, Congressman. You say there are only two things we are justified in looking into, two questions, impropriety and pressure.

Do you think it is part of our oversight function to see whether or not the Justice Department—in this or any other administration—is skillful in the use of the tools that are made available to them, that is, does it reflect competence?

Is that a question that we have a right to look at?

Mr. MCCOLLUM. Up to a point, you do, and I question just how far that goes. We did look at it, but I do not think in the end, that judging decisions of which way you go in prosecuting a case, which law, which interpretation, is very helpful to the process, and I do not know that that is necessarily a statement of competence.

But yes, you do have a right. In fact, your body probably has a greater right than mine, because you have to oversee the ultimate approval of the appointments to the Department of Justice and to the court system. So to that extent, I think your body has a greater responsibility on that score than mine.

Senator BIDEN. We found, for example, in previous administrations there were statutes on the books for which the administrations were asking for authority that already existed, like the forfeiture statute.

How long have you been on the House committee?

Mr. MCCOLLUM. I have been on it for 6 years, now.

Senator BIDEN. And we found things like the Justice Department had not had time to train the U.S. attorneys and make them cognizant of the way in which the forfeiture statute was intended to work. Since that occurred, forfeitures have become a very, very powerful tool.

I respectfully suggest to you, had the oversight hearings not begun, had we not brought that pressure on, insisted on knowing the details surrounding the training of prosecutors and the like, that that probably would have never happened.

But you do not have time, so I will not get into the number of questions I would like to ask you, and I will just say, as we say in our business, that we can agree to disagree.

Mr. MCCOLLUM. I think we will have to, Senator, because I think pressure on the topline people is one thing; pressure on the locals and the individual prosecutor's discretion is another.

But we do not have time, unfortunately.

Senator BIDEN. What I will do is send you a couple of questions, if I may, and ask at your leisure—maybe your staff could look at them, and you could give us the wisdom of your insight.

Mr. MCCOLLUM. I will be very glad to. Thank you.

If I might, I would like to make one final comment, if I could, Senator Biden.

Senator BIDEN. Sure.

Mr. MCCOLLUM. That is that the bottom line in looking at this, not debating the issue of how broad the oversight ought to be, is that when you look at it in the end—and I think you will come to the same conclusions, but you have got to go through your hearings, first—there really were not intent elements that could have been proven against the senior corporate officials, no matter what crime was charged, no matter what process went through. So individuals could not have been prosecuted successfully.

And in the end what I see in this case is that the Justice Department managed to get a frontline prosecutor out there in Al Murray who spent the better part of 3 years of his life and came up with a truly dramatic and beneficial decision for the public in the plea bargain.

I thank you for letting me have the opportunity.

Senator Metzenbaum. In view of your last statement, you made a conclusion with respect to the facts and the law. I want to know what the basis of that is. You just told us that there would have been no basis for an indictment prosecution of any of the top officials of E.F. Hutton.

Now, there is evidence before our committee that makes a suggestion to the contrary, and it is my opinion that that same evidence of knowledge and scienter was all before the House, as well; I am not sure if it was before your committee.

Mr. McCollum. Senator Metzenbaum, I listened to hours of that testimony, and I watched the evidence, looked at the evidence you are talking about, and frankly, I saw no evidence of scienter or knowledge on the part of the high corporate officials of the type of activity which was criminal.

There are two different types——

Senator Metzenbaum. You did not see, or you did see?

Mr. McCollum. Did not see any of the type that was criminal.

They had knowledge of the target balancing process that went on, but that is not criminal. They had knowledge of the cash management practices that they encouraged on a basis that they thought they were encouraging back down in the field to increase their profits at home. Those are the things which ultimately they agreed to stop in the civil injunction, but they were not criminal.

What they did not have knowledge of was the excessive and arbitrary overdrafts, the chaining operations, the things that clearly were violations of criminal law where intent could be proven only to the lower level officials. There was no element of knowledge of proof going up to the things that were actually crimes. And that is the beauty, I think, of the plea bargain in the end, that the plea bargain was to get rid of things that they did have knowledge of, but which were not at that time criminal activities, some of which would today be criminal activities because of the change in the law in 1984.

Senator Metzenbaum. I am not sure that you and I read all the factual data the same way. I do not want to get into a dispute with you as to whether they were or were not guilty of criminal acts, but certainly, the President, Mr. Ball, knew. He congratulated the firm's northeast regional director for the superb performance his office had in March of that year, and he said, "How did Rick manage to generate a 48 percent profit margin?" Referring to an unidentified subordinate, Mr. Witz, "Was it largely legal interest profit?"

He goes on to talk about the fact that these men knew that there was check-kiting going on; they knew it was deliberate acts; they knew it was creating profits for them; and they knew that those profits would otherwise have belonged to the banks.

What interests me, Congressman, is that, first, you question us about conducting oversight hearings with reference to the activities of the Department of Justice, which is really our main concern, including their prosecutorial staff, and second, then you come here before us, and you make the ultimate conclusion that you, the Congressman, says they were not guilty of any criminal acts on your own. I have difficulty with that, Congressman.

Mr. McCollum. Senator, I have two points to make, if I might, with you. One is that my bottom line conclusion is that even if you were right, and I believe you are wrong, about what you presented as criminal, but even if you were right about it, the nexus is so narrow—the odds were very heavily against Justice getting a conviction in a court, because what you took is out of context, is one small portion. Yes, I am aware of that. I think the odds were heavily against them getting a conviction of Mr. Ball in that one case, on the basis of that statement, and when you consider what they got in return, they got a good bargain.

With regard to what they were doing that Mr. Ball was aware of—and he clearly was aware of it; I think his statement that you just read indicates that—was perfectly legal at the time.

There is a difference between that procedure of trying to maximize their profits through what I call "target balancing", that is explained on the last page of my testimony, and the scheme of arbitrary overdrafts and "chaining", which was the taking of exorbitant profits. We went through a lot of this over in our hearings, and I really spent a lot of hours on this issue. I do not pretend to be the expert, but I do have a lot of absorption like you do when you sit on these hearings. My understanding is that when you are having an account as a securities broker out there, and you try to collect those moneys in your accounts at the local bank, you are making an effort in target balancing them to get those concentrated in New York as fast as possible.

When that is done, in the process of overdrafting—or was done at that time under the law—usually is an acceptable practice within the banking world and the securities world. As long as you have not come in—as the E.F. Hutton people did upon occasion, with extraordinarily large, sums unrelated to customer deposits. For example of $9,000, might have been the average in those accounts, and overdrafting for the $9,000 to come up with zero balance for the month on the average was legal target balancing. But at Hutton they came up with $900,000 instead. I am exaggerating the figures, but that is to give you the example—they put a $900,000 check in there so they could make some money over the weekend on that check that had no relationship to the accounts that they were taking in, that kind of overdrafting was what was really illegal, but that was not something that could ever be tracked back to the knowledge of the securities in New York.

And that is why I say that what I concluded from all this was the prosecutors made a wise and prudent decision because they could not prove anything but lower officials knew about this really illegal activity.

And the other was not, but they got rid of it by the civil injunction in the plea bargain, target balancing is something that you and I do not want to see them do, but it was not illegal at the time. They got rid of it by the plea bargain.

Senator METZENBAUM. I respect your point of view, Congressman, but I am not at all certain I agree with it.

Mr. McCOLLUM. I understand. Thank you very much for letting me present it, and I appreciate it, Senator.

Thank you.

Senator BIDEN. Before we ask Judge Bell to come up, I would like to make a brief opening statement.

This afternoon, we continue our hearing into the white collar crime issue, focusing for a second day on the prosecution by the Department of Justice of E.F. Hutton.

In my opening statement on the first day of our hearings, I tried to put the prosecution in a larger context of the place that trust always plays in a free society—trust between those who participate in our financial markets, and trust that our people must have in the agencies of Government if the law is to retain any legitimacy.

I need not repeat that statement now, but the facts themselves bear repeating as an introduction to today's hearing.

In May of last year, E.F. Hutton, Inc., pleaded guilty to 2,000 counts of mail and wire fraud in connection with its policy of aggressive cash management that resulted in as much as $10 million in overdrafts that bilked many of its 400 banks out of an estimated $8 million. It was check-kiting on a grand scale, even for a company that has annual revenues of $2.8 billion and profits of $5.2 million.

Government prosecutors say they had insufficient evidence to indict the key middle-level executives or Hutton's chief executive officers. They settled for a guilty plea by the corporation, a $2 million fine, and an agreement by the company to make up $8 million in restitution of the victims who came in, showed their losses, and claimed them.

Two investigations have been conducted in the E.F. Hutton affair. Congressman Bill Hughes of New Jersey has led the House in an able and comprehensive probe into what happened at E.F. Hutton and at Justice; and former Judge, Atty. Gen. Griffin Bell, has led the independent investigation at the request of E.F. Hutton into what happened within the company.

In light of the testimony on the first day, I would like to explore today at least three questions.

First, did Justice undervaluate the quality and force of the evidence it had at its disposal?

Second, did Justice misjudge the intentions and resolve of their adversaries?

And third, did Justice fail to understand and use the legal tools available to it?

I look forward to having an opportunity to question Judge Bell and am delighted to see him back here. I am not sure it is evidence of the fact that the work we do in the Judiciary Committee in overseeing judges is well-placed, because I know most judges, even though they have been Attorneys General of the United States of America prefer being called "Judge", which seems to me to suggest that they have their priorities straight.

I welcome you, Judge Bell, and I will figuratively and literally turn the gavel over to my Republican colleague.

Senator **Grassley**. No, please do not do that, because I came because there are a couple of points I want to hear from this witness, and then I am not going to be able to stay very long, because of the bankruptcy bill being on the floor of the Senate.

So I did not come to Chair; I was not asked by the Chairman to Chair, and I think they were planning on your doing that.

Senator **Biden**. All right.

Senator Metzenbaum.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator **Metzenbaum**. It is nice to have you before us again, Mr. Bell, and we are happy to hear from you. I am not certain—you have a written statement, which I have not seen—but I believe that we are concerned about several aspects of the matter.

You made a report in connection with the E.F. Hutton matter, and that dealt with your evaluation of E.F. Hutton. I am frank to tell you some of the elements concerning Griffin Bell in this matter cause me to believe it is not alone the substance of the report, but the conduct of Griffin Bell that is in question.

You were paid by this large corporation to make this report, sort of a self-serving document. It is hard to believe that it would come out on a rather negative basis. At the same time, according to my information, your firm was representing E.F. Hutton. And that would immediately suggest a conflict of interest. I do not know whether you continue to represent them.

It seems to me that the report today that came from Mr. Hughes, out of the House Committee, which indicated that "Bell's mission was one of damage control for Hutton," said Mr. Hughes, and Congressman Harry Hughes has been rather troubled by the way State agencies have used the Bell report as a bible, adding that he felt Bell had a potential conflict of interest with the company he was investigating.

I too have that concern, and I am aware of that fact I assume that you do a substantial amount of business with the U.S. Attorney General's Office. I note that you saw fit when this committee was considering the confirmation of Brad Reynolds, a totally separate matter, that you saw fit to write an article telling us in so many words, "Confirm Brad Reynolds."

So I get the feeling that in being the impartial person to make a determination on this matter, that we would like to know, or at least I would like to know, how you feel that your position could be considered to be an objective one and an impartial one under the circumstances. It does disturb me, and it is quite obvious that it disturbs a number of other people as well, as indicated by the Hughes report today and some other articles that have been written on the subject.

So I would hope that in your statement you would give us the kind of reassurance that I think you need, and we would hope to have, to make us feel that your report that has sort of become a bible for so many State agencies was indeed that objective document that ostensibly it was.

Mr. **Bell**. Is that a question?

Senator **Metzenbaum**. No, it is not a question, just keep it in mind when you speak.

Senator **Biden**. Does the Senator have an opening statement?

Senator **Grassley**. No, I do not. Thank you.

Senator **Biden**. I have a statement here by Congressman William J. Hughes that I will place in the record.

[The statement follows:]

STATEMENT OF CONGRESSMAN WILLIAM J. HUGHES

BEFORE THE SENATE COMMITTEE ON THE JUDICIARY

MAY 8, 1986

Last May, E.F. Hutton & Company, Inc. pleaded guilty to 2000 counts of mail and wire fraud in the Middle District of Pennsylvania. No individuals were charged with the wrongdoing. Following a public outcry because of the Department's failure to seek to hold any individuals accountable, Hutton retained Griffin Bell to investigate the circumstances surrounding its guilty plea.

Hutton has portrayed Judge Bell's report as that of an independent investigator. It has relied on his report in making decisions on how to treat individual Hutton officers and employees implicated in the wrongdoing, and has provided the report to various State agencies with authority to revoke the licenses of those individuals and of Hutton itself. In essence, Hutton asked Judge Bell to do the job the Department of Justice never did -- that of making a determination of individual accountability within the Company for the criminal acts.

Judge Bell's report is nothing more than an attempt at "damage control" by Hutton. No matter how they attempt to "dress it up" as an independent and objective assessment, it falls far short of that goal. First, Judge Bell is not independent. He is employed by Hutton and his mission was set forth by Hutton. Hutton has claimed attorney-client privilege on documents subpoenaed by the Subcommittee on Crime, yet has shared those documents with Judge Bell and has refused to make Judge Bell's working papers public. Although Judge Bell has compared himself to an English "royal commission," he was retained by Hutton, paid by Hutton, and is accountable to Hutton.

Judge Bell's investigation was well financed and well staffed; he had 14 lawyers and 4 paralegals working for almost 4 months before he released his report. His instructions were to take all the time he needed to complete his investigation.

The staff of the Subcommittee on Crime, which I chair, has analyzed Judge Bell's report and has found that, despite Judge Bell's mandate and resources, there are a number of major weaknesses in it. I have appended to my statement this comprehensive analysis, but intend here to comment on just a few major points.

As in any investigation, Judge Bell was confronted with a number of conflicting stories from various Hutton employees. In many key instances, he chose either not to resolve those conflicts or to resolve them without explanation or supporting evidence. For example, according to Bell, John Pearce, the Bethesda, and then St. Louis branch manager, "claims that the St. Louis/Bethesda drawdown was approved by Michael Wallace, the Central Regional Operations Manager. Wallace denies this assertion." No attempt was made to resolve this inconsistency. He did, however, conclude that certain of the individuals were responsible for the criminality and recommended sanctions against them. Ultimately, Judge Bell concluded that the higher level employees were to be believed because, in general, the harshest sanctions were meted out to the lower level employees. In the example cited above, Judge Bell recommended that John Pearce be fined $25,000 to $50,000, be placed on probation for 1 year, and have a letter of reprimand placed in his personnel file. Bell did not recommend any punishment for Wallace.

Judge Bell's investigation failed to deal with all relevant facts. For example, he simply ignored over 60 branches involved in illegal chaining -- branches identified by the Department of Justice and by Hutton itself. In this way, it appeared that the scope of Hutton's wrongdoing was much less than it actually was. Furthermore, while there were 25 chains identified by the Department, Judge Bell acknowledged and dealt with only 15 of those chains.

According to Judge Bell, Hutton should not have pleaded guilty to all 2000 counts. For example, he alleged that in at least one instance charged by the Department, involving the Hutton branch in Louisville, Kentucky, there was no fraud and no criminal wrongdoing because the bank was aware of Hutton's activities. The facts are otherwise. Hutton's bank in Louisville was not aware of Hutton's practices, did not agree to them, and after several months of attempting to get Hutton to stop overdrafting, threatened to close the account. Judge Bell cited as support a letter from the bank; however, we have learned that the language of the letter was suggested by Hutton's Louisville branch manager, and that bank officials would have been more complete if they had fully understood the purpose of the letter.

The report attempts to minimize the harm to the banks where Hutton illegally overdrafted. Judge Bell asserted that most of these banks were either aware of Hutton's conduct or consented to it. This is wrong. Many of Hutton's banks became aware of the overdrafting and demanded that Hutton cease the practice and compensate them for their losses. I do not understand how Judge Bell can call this consent. It does not follow that, just because the criminal has returned the illegally gotten gains, there has been no crime.

The Department of Justice charged, and Hutton pleaded guilty to, 2000 counts of mail and wire fraud, perpetrated by 113 offices. Judge Bell, however, exonerated 28 of these offices, representing 168 counts and $128 million based on interviews and his review of documents; he exonerated another 55 offices, representing 656 counts and $1.215 billion, because the office personnel denied overdrafting in amounts beyond those mandated by the drawdown worksheet. One of these branches -- Washington, D.C. "Eye Street" -- was responsible for 97 counts and $436 million in transactions. Apparently Judge Bell simply accepted the employees' statements and did not independently evaluate them. In addition, he failed to deal at all with 10 offices, representing 176 counts and $623 million.

The branch manager of the Washington, D.C. "Eye Street" Office was Perry Bacon, one of the most egregious offenders within Hutton. Mr. Bacon managed the Alexandria branch as well, where Hutton also overdrafted in enormous amounts. In approximately one year, beginning in early 1981, bank accounts maintained by Mr. Bacon for his two branches were overdrafted by a total of more than $1 billion. Hutton Chairman Fomon, relying on

Judge Bell's report, described Mr. Bacon as " 'responsible for enacting and supervising a sophisticated scheme of overdrafting the Alexandria branch bank account,' including the drawing down of 'bogus' deposits. Your conduct, he concluded, 'was such that no reasonable person could have believed that this conduct was proper.' " Mr. Bacon was granted immunity by the Department of Justice, and so was never prosecuted. Judge Bell recommended sanctions against Mr. Bacon: a $25,000 to $50,000 fine, a letter of reprimand, and one year's probation. Instead, Hutton negotiated Mr. Bacon's termination from the Company. According to Mr. Fomon, Mr. Bacon never paid his fine because, as Judge Bell recommended, if an employee left the Company, payment of the fine was unnecessary. Even if Mr. Bacon had paid his fine, however, it would hardly have constituted punishment. Hutton agreed, as part of its severance agreement, to pay Mr. Bacon $630,000 plus contingencies. It also agreed to help Mr. Bacon establish a new business. Finally, the Company agreed not to sue Mr. Bacon, a commitment from which it is released if Mr. Bacon fails to cooperate "with the Company" in any investigations of Hutton's wrongdoing. When I asked Mr. Fomon for an explanation of this payment, his response was that Hutton makes payments to all of its employees who are terminated from the Company, and this one was no different. To Mr. Fomon, it may be "business as usual;" to others -- like me -- it looks like "hush money."

The inevitable result of the Justice Department's failure to prosecute individuals is that it permitted Hutton to investigate itself, to mete out its own punishment in a manner designed to promote the interests of the Company, not of justice, and to use its own conclusions in negotiating with the various states deciding whether to revoke the Company's license. In general, Hutton as a corporation has not been severely punished by the states. In exchange for protecting its license, the Company has bargained away the rights of its individual employees, and their opportunities to do business within those states. In nearly every instance, the states have relied on the Bell report in punishing the individuals and in concluding that the Company --

because it has punished the individuals itself and has taken steps toward "rehabilitation" -- should not be further penalized.

It is the Department of Justice that ultimately should have sought a determination of individual liability for Hutton's wrongdoing. By its failure to do so, the Department left Hutton the opportunity to shape its own inquiry and conclusions in the light most favorable to the Company.

Senator **BIDEN**. Judge, why don't you proceed with an opening statement or any way you would like to proceed, and then we have questions.

STATEMENT OF HON. GRIFFIN BELL, KING AND SPALDING, ATLANTA, GA

Mr. **BELL**. Well, I have a very short statement, and I will try to answer the several things that Senator Metzenbaum mentioned.

I was employed by the E.F. Hutton Co. Group, Inc.—that is a parent company—to review the practices that led to the guilty plea of E.F. Hutton & Co.—that is the broker dealer. The plea was entered in the U.S. district court for the middle district of Pennsylvania on May 2, 1985, and part of my charter was "to determine how those practices evolved, to identify those individuals who bear personal responsibility, whether officers or employees, and to make recommendations to Hutton with respect to these individuals."

That was a letter I had in writing from the CEO of Hutton, Mr. Foman.

I was not retained by Hutton to, and, therefore, did not review, the adequacy or appropriateness of the Justice Department's investigation or of the decision of either the Justice Department or the broker-dealer E.F. Hutton to enter the agreement disposing of the investigation, including the plea of guilty to 2,000 counts of mail fraud, which were felonies.

My investigation lasted slightly more than 3 months. During that period, my staff of 15 lawyers assisted by four paralegels conducted more than 300 personal interviews, including interviews with former and present Hutton employees from every level of the company throughout the Nation, including New York headquarters. I might say we went into 141 Hutton branch offices in 43 States during those interviews.

We devoted 6,630 lawyer hours, not counting my own time, and 2,873 paralegal hours to the investigation.

Thirty-eight individuals were interviewed in Hutton's nine regional offices and over 30 officers and employees at Hutton's New York headquarters were interviewed.

We conducted interviews at 63 banks throughout the country with which Hutton had or has account relationships.

We met with Arthur Anderson & Co., Hutton's outside auditors, and interviewed them in some depth—I personally did—and Arthur Young & Co., which had also been brought in to advise Hutton's outside counsel on cash management practices.

I also interviewed the directors of the Hutton Group who made up the Audit Committee of the Board.

We conferred on several occasions with the Justice Department attorneys who prosecuted the case. These lawyers cooperated in the investigation by generally outlining the case against Hutton without violating the rule against disclosing information obtained in the grand jury.

We reviewed the formal pleadings filed in the case, including the 2,000-count Information, the Plea Agreement, the Consent and Undertakings of the Hutton Group and the Hutton Co.—which was part of the injunction—and the Complaint for Permanent Injunction and Ancillary Relief, in addition to the transcript of the hearing on the plea.

We met on several occasions with attorneys from the Securities and Exchange Commission and offered to provide information to them to assist in their investigation of the Hutton Co.

After I was employed by E.F. Hutton, I met with the executive committee—and this gets to the Hughes statement—of the North American Securities Administrators Association. Those are the State regulators. I met with them at their request, and I will give you the details of it. I met with them at the Atlanta airport. They flew the entire executive committee into Atlanta to interrogate me about the kind of investigation I had been employed to do. They interrogated me as to my independence. They asked me whether we had done business with Hutton before as a law firm. One of them had some information that I did not have about something we were doing at that very moment for Hutton. They asked me if I would make whatever facts we developed available to them, and I agreed to do that, and I have done it.

They made their own determination as to whether I was a person of integrity and independence, and they decided apparently that I was, because they have been using my material, and in fact, they told me so when I met with them in Calgary, Alberta, in September in a closed session to give an outline of what we had found. We worked out an arrangement where we gave each one of them a package, and I sent lawyers who may have investigated in a particular State to meet with them. I will give you the details of the things they were worried about, my independence, in a second.

During the course of the investigation, we reviewed approximately 11,000——

Senator METZENBAUM. Excuse me, Mr. Bell.

Mr. BELL. Yes, sir.

Senator METZENBAUM. I do not want to interrupt you, but as long as you mentioned that your firm was doing work for E.F. Hutton at that time, would you elaborate on that and tell us how long you had been representing them. What were you doing then? What will your future relationship be?

Mr. BELL. We have a very large public finance department in our law firm, and we do bond issues throughout the Nation. And we had done a few bond issues for Hutton. Hutton predominantly uses another firm in Atlanta.

At the time I took this employment, that was disclosed by Mr. Foman at the stockholders' meeting the next day after I agreed to do the investigation. It was publicly disclosed. It was in a press release.

At this meeting I had with the State securities administrators, the 10 people, at the Atlanta Airport, one of these administrators asked me about our representation of Hutton, and I told him what I have just told you, which is a very minor matter. He said, "Do you know at this very minute that your firm's Securities Department is handing a securities issue for Hutton?"

And I said no, I did not know that, but I will find out about it. I never heard of it before.

I did check up, and I found out that a tax lawyer in our law firm here in the Washington office had worked out some type of problem Hutton had in connection with a securities issue which had something to do with an issue in Pennsylvania, and that that was going on. And that went on—we built what we called "the Chinese Wall"—I never knew exactly what they were doing or what fee they were making, or anything of that sort. And later on, the Pennsylvania securities commissioner would not give clearance on that issue unless there was some sort of a note added saying that I was doing the special investigation, and at the same time the law firm was doing the securities issue. That was it. That is all I know anything about.

Now, you asked another question, do we do any business for Hutton now, or have we since I finished this report. Without pinning myself down—I have not looked at the record—only know of one matter we have done. That same tax lawyer worked out an arrangement whereby you could have a securities issue based on underlying real estate, and it is called—it was for Aetna, Aetna and Hutton. That is all I can tell you about it, but it was a sizeable transaction. I think it has just come out.

Senator METZENBAUM. Was there a matter called Hutton GSHA American Storage Properties that your firm represented?

Mr. BELL. That could be the same one they were asking me about. I do not know the name of the one that we did. I will be glad to submit the exact name of it.

Senator METZENBAUM. Are you aware of the fact—I am looking at the Wall Street Journal. "However, Mr. Cohn said the Pennsylvania Commission staff felt that Hutton's failure last June to note the connection between Mr. Bell and King and Spalding, when Hutton notified State securities regulators of Mr. Bell's appointment to conduct the special investigation, was misleading. Mr. Cohn said the staff discovered the connection purely by accident."

Mr. BELL. Who said that?

Senator METZENBAUM. I am reading from the Wall Street Journal.

Mr. BELL. Yes. That is the thing I just told you about——

Senator METZENBAUM. It says, "Mr. Cohn said the staff discovered the connection purely by accident."

Mr. BELL. That is the one that in July when I met with the State securities regulators, that is the same transaction they asked me about at that time, that I just got through telling you about.

Some months later, maybe a month or two—I do not remember when it was, a month or two later—is when the Pennsylvania regulator said he would not give a "blue sky" clearance unless they put a note in their prospectus that at the time I agreed to be the special investigator, we were also representing Hutton in this transaction you mentioned.

Senator METZENBAUM. Was King and Spalding paid by Hutton for this investigation?

Mr. BELL. Oh, yes.

Senator METZENBAUM. At your regular fee rate?

Mr. BELL. At larger than the regular fee rate.

Senator METZENBAUM. Larger than your regular fee. Would you be good enough to tell us what that total fee was?

Mr. BELL. We have a firm policy—and I stated this at the press conference I had on the Hutton report—of not disclosing a fee. But

I said then and I will say now, if Hutton will give it to you, it is fine with me.

Senator **Metzenbaum**. You said that it was larger than your normal fee rate—Why?

Mr. **Bell**. Because we did it on an emergency basis. These lawyers never got a vacation. They worked sometimes 48 hours without stopping toward the end. And I charged an extra premium because of the hard work they were doing.

Senator **Metzenbaum**. Then, without telling us the exact amount, if you prefer not to do so, how did you determine what that premium would be?

Mr. **Bell**. Well, I did it after I finished, and I did it out of my head.

Senator **Metzenbaum**. Well, was it——

Mr. **Bell**. I took the underlying hours, and added something to that.

Senator **Metzenbaum**. Would you tell us what you added? I do not care about the dollar amount, but—did you add a dollar amount or a percentage amount?

Mr. **Bell**. Well, let me see if I can start over. Shortly after I started the investigation, some top officer at Hutton asked me what I was charging. I said, "We are charging by the hour, and I will have to tell you what we are going to charge." So at that time, I set an hourly rate which was a little higher than our regular rate. But I said, "I do not work by the hour myself. And when we finish, I will charge you some fee, whatever I think it is worth, and you do not have to pay it unless you think it is worth it." So I added my own fee to the hourly rate.

Senator **Metzenbaum**. Well, here is what I am trying to get at, Mr. Bell, and I think you can appreciate it. You came out with a report that I think everyone would agree helped Hutton——

Mr. **Bell**. I do not think everyone would agree on that. The people who lost their jobs would not agree, I am sure.

Senator **Metzenbaum**. Well, there were not that many who lost their jobs.

Mr. **Bell**. One was a senior vice president.

Senator **Metzenbaum**. Pardon me?

Mr. **Bell**. One was a financial vice president and a member of the board.

Senator **Metzenbaum**. But the fact is that, by and large it was considered pretty much of a clean bill for them; it was not a total clean bill, but it was not, certainly, too hurtful.

I understand that a lawyer normally would not feel that the amount of fees he charged a client is public information. But this is a public matter, and this is a matter in which you are appearing before a Senate committee that is inquiring as to how this company was able to get off scot free without anybody individually being indicated. There is tremendous concern in the country about whether there is a different standard of justice for the poor and the rich, and they bring in Griffin Bell, former Attorney General of the United States, who ostensibly is called in to "call it as he sees it." He is to make a totally independent judgment as to whether the conduct was right, wrong, and to make some judgment calls as well and factual decisions.

Mr. **Bell**. Yes.

Senator **Metzenbaum**. I think, Mr. Bell, under those circumstances, particularly in view of the fact there was a premium—and I guess I would have to ask would there have been a premium paid or charged if the result was more negative than it was—but I think under the circumstances that this committee is entitled to know what that premium was and what the total fee was.

Mr. **Bell**. I have got no problem at all with you knowing it, Senator. All you have got to do is ask Hutton. If they want to tell you, it is fine with me. I just do not tell my clients' business. I have not started that yet. I have been practicing law a long time.

Senator **Metzenbaum**. I know. But don't you think that there is more than your client's business involved in this one? It is the Nation's business as well. It is the integrity——

Mr. **Bell**. I have just said I am sure Hutton will give you the fee; if they want to do it, that is fine with me. I am giving you clearance right now to get the amount of the fee from Hutton.

But I will tell you this. I want to add one thing, since I am the witness. I did not get paid enough, because I have been harassed by the House committee as of yesterday—not by the committee, but by one member, Mr. Hughes. You are harassing me now. And I have not gotten any pay for that. And I have been sued by one of the branch managers that I recommended a sanction on. So I did not get paid for that. And I did not get indemnified against suits. So I do not think I charged enough.

Senator **Metzenbaum**. Well, let me just say, Mr. Bell, that one man's harassment may be a Senator's proper line of inquiry. And if you feel harassed, I am sorry about that.

Mr. **Bell**. Well, at least you gave me a chance to testify, and I thank you very much for that.

Senator **Metzenbaum**. And I do not consider myself harassing you. I am trying to get at the facts in connection with this matter, and I am putting everything up on the table that I know.

I will say to you that in connection with the Brad Reynolds' article, I do not know that it is particularly relevant. But I have not yet raised the question that that article as I understand it was written at the very time that your office was being investigated by the Attorney General's Office with respect to female discrimination.

Mr. **Bell**. That is absolutely wrong. You see what you are doing, you are going all over the lot. And as an American citizen, I have a right to take a position on somebody's appointment. I am still an American. So if I want to support Brad Reynolds, I have a right to do that.

Now, we had a sex discrimination suit against our law firm which I think was settled about 3 years ago.

Senator **Metzenbaum**. And it was not pending at the time you wrote the article?

Mr. **Bell**. Absolutely not, absolutely not. I mean, that is scurrilous to make a statement like that.

Senator **Metzenbaum**. Well, if I was misinformed by staff, then, if that is incorrect, then I would apologize to you because I thought there was a time relationship.

Mr. **Bell**. I think you had better get a better class of staff if they told you that.

Senator **Metzenbaum**. Well, I would be very happy to do that if you think I should, Mr. Bell. I always try to accommodate you.

I will have further questions.

Senator **Biden**. Judge——

Senator **Metzenbaum**. I think he has not finished.

Senator **Biden**. Oh, I am sorry.

Mr. **Bell**. Well, I wanted to read my statement, but I think I will not read it here. It has been filed anyway, so I will just give up on the statement.

Senator **Biden**. All right. The entire statement will be placed in the record.

[Statement follows:]

STATEMENT OF
GRIFFIN B. BELL

Mr. Chairman and members of the Committee:

As you know, I was employed by The E.F. Hutton Group Inc. to review the practices that led to the guilty plea of E.F. Hutton & Company Inc. in the United States District Court for the Middle District of Pennsylvania on May 2, 1985, and to "determine how those practices evolved, identify those individuals who bear personal responsibility (officers or employees) and make recommendations with respect to these individuals." (See letter of May 28, 1985 from Robert Foman, attached as Exhibit A to this statement.)

I was not retained by E.F. Hutton to, and therefore did not, review the adequacy or appropriateness of the Justice Department's investigation or of the decision of either the Justice Department or the broker-dealer, E.F. Hutton & Company Inc., to enter the agreement disposing of the investigation, including the plea of guilty to two thousand counts of mail fraud.

The ensuing investigation lasted slightly more than three months. During that time period, my staff of fifteen lawyers, assisted by four paralegals, conducted more than 300 personal interviews, including interviews with former and present Hutton employees from every level of the company throughout the nation, including New York headquarters. A total of 6,630 attorney hours, excluding my time, and 2,873.3 paralegal hours was devoted to this investigation. Employees in one hundred forty-one Hutton branch offices in 43 states were interviewed. Thirty-eight individuals were interviewed in Hutton's nine regional offices. Over thirty officers and employees at Hutton's New York headquarters were interviewed. In addition, we conducted interviews at 63 banks throughout the country with which Hutton had or has account relationships. We also met with Arthur Andersen & Co., Hutton's outside auditors, and Arthur Young & Company, the firm employed by Hutton's outside counsel for advice on cash management practices. We also interviewed the directors of the Hutton Group comprising the Audit Committee.

We conferred on several occasions with the Justice Department attorneys who prosecuted the case. These lawyers cooperated in the investigation by generally outlining the case against Hutton without violating the rule against disclosing information obtained in the grand jury. We reviewed the formal pleadings filed in the case, including the 2,000 count Information, the Plea Agreement, the Consent and Undertakings of the E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., and the Complaint for Permanent Injunction and Ancillary Relief in addition to the transcript of the hearing on the plea.

We met on several occasions with attorneys from the Securities and Exchange Commission and offered to provide information to them to assist in their investigation of E.F. Hutton & Company.

After I was employed by E.F. Hutton, I met with the Executive Committee of the North American Securities Administrators Association (NASAA). I later addressed the annual meeting of NASAA in Calgary, Alberta. After that meeting we made available on request to state securities regulators packages of documents relating to Hutton branches in that state as well as a computerized summary of our investigation of the E.F. Hutton branches in that state. Some of our lawyers also assisted several states in their investigations.

During the course of the investigation, we reviewed approximately 11,000 nonfinancial documents consisting of approximately 40,000 pages of memoranda, correspondence, reports and notes. In addition, we reviewed thousands of bank reconciliations, blotters, ledgers and other financial documents.

My investigation addressed five problems. The first and most substantial problem, and the one having the most to do with the guilty plea, concerned the excessive overdrafting of certain bank accounts maintained by Hutton throughout the country. The second problem we investigated was known as "chaining," which involved transfers of money from branch to branch accounts for several reasons, including attempts to capture the float and increase interest profits. The third problem, labeled as "criss-crossing" or "facilitating transactions" by the Justice Department involved same-day multimillion dollar check swaps between Hutton accounts at Manufacturers Hanover Trust Company and Chemical Bank. The fourth problem concerned deficiencies with the machine readable codes printed on some of Hutton's checks. The fifth and last problem was added at Hutton's request after the investigation commenced, and concerned the apparent failure of Hutton to respond fully to subpoenas issued in connection with the grand jury investigation that preceded the plea agreement of May 2, 1985.

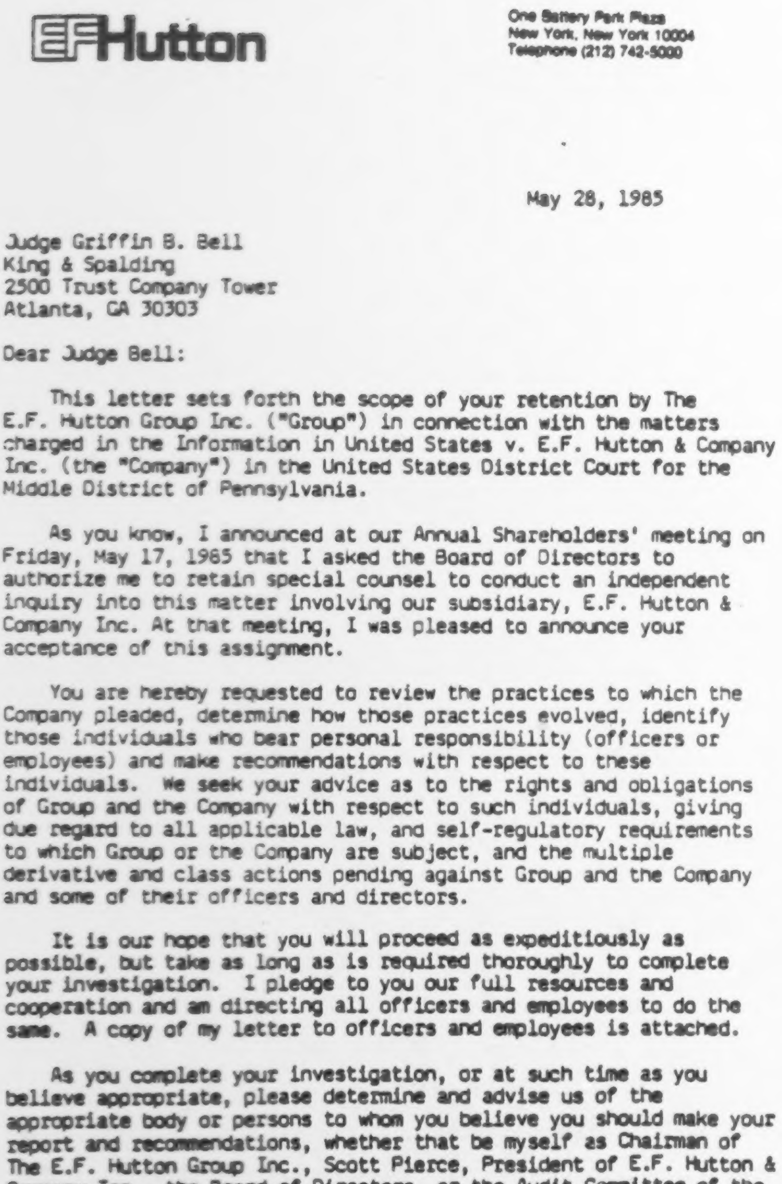
Although our investigation benefited from information made public by the Justice Department at the plea taking on May 2, 1985, we used several additional criteria in an effort to identify the practices and responsible individuals. An example of the additional criteria used is found in Exhibit 12 of the Appendix to The Hutton Report, which is attached to this Statement as Exhibit B. This Exhibit reflects the criteria we used in an effort to determine those Hutton branches involved in excessive overdrafting and chaining.

The findings of my investigation are published in The Hutton Report which was made public pursuant to an understanding with Hutton prior to completion of the Report.

I note that Congressman William J. Hughes, Chairman of the House of Representatives Subcommittee on Crime, is to appear before this Committee to give his views on the E.F. Hutton investigation. I offered to appear before Chairman Hughes' Subcommittee, but was never called. (See letter of September 6, 1985 to Chairman Hughes, attached as Exhibit C to this statement).

I appreciate the opportunity which this Committee has given me to answer questions regarding the findings of my investigation.

EXHIBIT A



EFHutton

One Battery Park Plaza
New York, New York 10004
Telephone (212) 742-5000

May 28, 1985

Judge Griffin B. Bell
King & Spalding
2500 Trust Company Tower
Atlanta, GA 30303

Dear Judge Bell:

This letter sets forth the scope of your retention by The E.F. Hutton Group Inc. ("Group") in connection with the matters charged in the Information in United States v. E.F. Hutton & Company Inc. (the "Company") in the United States District Court for the Middle District of Pennsylvania.

As you know, I announced at our Annual Shareholders' meeting on Friday, May 17, 1985 that I asked the Board of Directors to authorize me to retain special counsel to conduct an independent inquiry into this matter involving our subsidiary, E.F. Hutton & Company Inc. At that meeting, I was pleased to announce your acceptance of this assignment.

You are hereby requested to review the practices to which the Company pleaded, determine how those practices evolved, identify those individuals who bear personal responsibility (officers or employees) and make recommendations with respect to these individuals. We seek your advice as to the rights and obligations of Group and the Company with respect to such individuals, giving due regard to all applicable law, and self-regulatory requirements to which Group or the Company are subject, and the multiple derivative and class actions pending against Group and the Company and some of their officers and directors.

It is our hope that you will proceed as expeditiously as possible, but take as long as is required thoroughly to complete your investigation. I pledge to you our full resources and cooperation and am directing all officers and employees to do the same. A copy of my letter to officers and employees is attached.

As you complete your investigation, or at such time as you believe appropriate, please determine and advise us of the appropriate body or persons to whom you believe you should make your report and recommendations, whether that be myself as Chairman of The E.F. Hutton Group Inc., Scott Pierce, President of E.F. Hutton & Company Inc., the Board of Directors, or the Audit Committee of the Board (consisting of the outside Directors of Group), or such combination as you may determine.

Sincerely,

Robert Fomon

Robert Fomon
Chairman, The E.F.
Hutton Group Inc.

Branches where it is suspected that chaining or overdrafting may possibly have occurred. This is not a list of branches where illegal conduct has been confirmed.

		Branches with $10,000 in general ledger bank balance interest for any month in 1982	Branches with $30,000 in general ledger interest for any month in 1981	Branches writing 10 or more Chemical Bank BRC's, BRC's in excess of $1 million or average BRC's in excess of $500,000 for any month 1/1/81 - 3/21/81	Branches writing 10 or more United States Trust Company BRC's, BRC's in excess of $1 million or average BRC's in excess of $500,000 for any month 12/1/81 - 3/21/82	Branches identified as possibly engaging in excessive drawdowns by Hutton's outside counsel	Branches identified as possibly engaging in excessive drawdowns by W. Sullivan	Branches identified in Counts 101-2,000 of information	Branches identified as being in a chain by either Hutton's outside counsel or DOJ or by Hutton's internal auditors
Akron, OH	(A29)							X	X
Albany, NY	(J42)								X
Albuquerque, NM	(H27)		X						X
Alexandria, VA	(C20)	X	X	X	X	X	X	X	
Allentown, PA	(A27)				X			X	X
Anchorage, AK	(K32)				X		X	X	
Ann Arbor, MI	(F01)								X
Atlanta, GA	(R95)		X	X				X	X
Atlanta, GA	(R57)								X
Atlanta, GA	(R93)								X
Austin, TX	(N89)			X				X	
Bakersfield, CA	(L61)	X			X		X		
Baltimore, MD	(C17)	X	X	X	X		X	X	
Barrington, IL	(F30)								X
Batavia, NY	(J02)	X			X		X		X
Baton Rouge, LA	(N47)			X		X		X	X
Beaumont, TX	(N90)							X	
Belle Glade, FL	(R04)							X	

EXHIBIT B

Branches where it is suspected that chaining or overdrafting may possibly have occurred. This is not a list of branches where illegal conduct has been confirmed.

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Bethesda, MD	(C32)	X	X	X	X	X	X	X	X
Beverly Hills, CA	(L62)	X			X		X	X	
Binghamton, NY	(J03)								X
Boca Raton, FL	(R27)			X					
Boston (Boston Pl.), MA	(J30)	X	X					X	X
Boston (Boston Pl. Su. 3030), MA	(J39)			X					
Boulder, CO	(H02)			X				X	X
Bryan, TX	(N91)							X	
Buffalo, NY	(J06)	X					X		X
Burlington, MA	(J40)								X
Burlington, VT	(J37)	X	X				X		X
Cape Coral, FL	(R07)			X				X	
Carmel, IN	(F25)								X
Casper, WY	(H20)			X	X		X	X	X
Charlotte, NC	(R09)			X				X	
Cherry Hill, NJ	(A10)							X	X
Chestnut Hill, MA	(J36)								X
Chicago, IL	(F40)		X						

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		Branches with $10,000 in general ledger bank balance interest for any month in 1982	Branches with $30,000 in general ledger interest for any month in 1981	Branches writing 10 or more Chemical Bank BBC's, BBC's in excess of $1 million, or average BBC's in excess of $500,000 for any month 1/1/80 - 3/21/81	Branches writing 10 or more United States Trust Company BBC's, BBC's in excess of $1 million, or average BBC's in excess of $500,000 for any month 12/1/81 - 3/21/82	Branches identified as possibly engaging in excessive drawdowns by Hutton's outside counsel	Branches identified as possibly engaging in excessive drawdowns by W. Sullivan	Branches identified in Counts 101-2,000 of Information	Branches identified as being in a chain by either Hutton's outside counsel or by Hutton's internal auditors
Cincinnati, OH	(A35)			X				X	X
Clayton, MO	(C15)	X			X		X	X	
Clearwater, FL	(R10)			X				X	X
Cleveland, OH	(A39)	X	X	X	X		X	X	
Colorado Springs, CO	(H07)		X						X
Columbia, SC	(R12)			X				X	
Columbus, OH	(A48)		X	X	X			X	X
Concord, MA	(J51)								X
Dallas (Quorum Dr.), TX	(N01)		X					X	
Dallas (Bryan Tower), TX	(N09), (N82)	X	X	X	X	X	X	X	X
Dallas (Park Central), TX	(N34)			X				X	X
Denver, CO	(H74)			X			X		X
Des Moines, IA	(C05)			X	X			X	
Detroit, MI	(F02)	X	X		X	X	X	X	X
Durham, NC	(R32)			X					
East Lansing, MI	(F05)				X			X	X
El Paso, TX	(H83)		X						X
Elmira, NY	(J18)				X				X

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Erie, PA	(A41)							X	X
Flint, MI	(F21)								X
Flossmoor, IL	(F48)								X
Ft. Collins, CO	(H11)				X				
Ft. Lauderdale, FL	(R47)			X					
Ft. Pierce, FL	(R17)			X	X		X	X	
Ft. Worth, TX	(N14)		X				X	X	
Fresno, CA	(L72)	X	X	X	X	X	X	X	
Garden City, NY	(A08)								X
Glens Falls, NY	(J41, A32)		X		X			X	X
Grand Rapids, MI	(F03)	X	X		X		X	X	X
Great Neck, NY	(A17)	X	X	X	X		X		X
Harrisburg, PA	(A11)	X					X	X	
Hartford, CT	(J27)	X	X	X	X		X	X	X
Hingham, MA	(J35)								X
Honolulu, HI	(K01)		X		X		X	X	
Houston (West Loop), TX	(N05)						X		

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Houston (Commerce Tower), TX	(N87)	X	X					X	X
Houston (Greenway Plaza) TX	(N93)		X					X	X
Huntington, NY	(A15)			X	X				X
Huntington, WV	(A43)	X	X		X		X	X	X
Hyannis, MA	(J28)								X
Janesville, WI	(F18)								X
Kalamazoo, MI	(F04)					X			X
Kansas City, MO	(C22)	X	X	X	X	X	X	X	X
Kenwood, OH	(A84)			X			X	X	
Knoxville, TN	(C30)							X	
LaCrosse, MI	(F23)								X
Laconia, NH	(J34)								X
Lafayette, LA	(N48)						X	X	X
La Jolla, CA	(L57)			X	X		X	X	
Las Vegas, NV	(H30)	X	X		X		X	X	X
Lincoln, NE	(C14)							X	
Locust Valley, NY	(A15)								X
Longmont, CO	(H03)							X	

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Longview, TX	(N86)						X	X	X
Louisville, KY	(C34)	X	X		X		X	X	X
Lubbock, TX	(N81)							X	X
Madison, WI	(F12)								X
Manchester, NH	(J33)	X					X		X
Mandeville, LA	(N60)							X	X
Memphis, TN	(C45)		X	X	X		X	X	
Mesa, AZ	(H04)	X	X		X		X		X
Miami, FL	(R24)							X	X
Miami Beach, FL	(R38)	X	X	X	X		X	X	X
Milwaukee, WI	(F14)				X		X	X	X
Minneapolis, MN	(F17)	X			X		X	X	X
Mobile, AL	(N49)					X		X	X
Modesto, CA	(K04)			X	X			X	
Montgomery, AL	(R08)			X	X		X	X	
Nashville, TN	(C35)			X					
Newark, NJ	(A18)								X
New Brunswick, NJ	(A20)				X		X	X	

Branches where it is suspected that chaining or overdrafting may possibly have occurred. This is not a list of branches where illegal conduct has been confirmed.

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New Orleans, LA	(N46)	X	X	X	X		X	X	X
Newport, RI	(J45)								X
New York (One State St. Plaza), NY	(A02)	X	X				X		X
New York (One State St. Plaza), NY	(A23)					X	X		X
New York (767 Fifth Avenue), NY	(A03)	X	X	X		X	X		X
New York (650 Fifth Avenue), NY	(A22)				X	X	X		X
New York (1700 Broadway), NY	(A07)								X
New York (950 Third Ave), NY	(A16)	X	X		X	X	X		X
New York (1 Battery Pk), NY	(A19)	X					X		X
New York (605 Third Ave), NY	(A45)								X
Niagara Falls, NY	(J07)								X
North Fresno, CA	(L23)				X	X		X	
Oakbrook, IL	(F22)								X
Ocala, FL	(R19)						X		
Ogden, UT	(H17)				X		X		
Oklahoma City, OK	(N32)		X				X	X	X
Olean, NY	(J08)				X				X
Omaha, NE	(C29)		X					X	

Branches where it is suspected that chaining or overdrafting may possibly have occurred. This is not a list of branches where illegal conduct has been confirmed.

		Branches with $10,000 in general ledger bank balance interest for any month in 1982	Branches with $30,000 in general ledger interest for any month in 1981	Branches writing 10 or more Chemical Bank BAC's, BAC's in excess of $1 million, or average BAC's in excess of $500,000 for any month 1/1/81 - 3/21/81	Branches writing 10 or more United States Trust Company BAC's, BAC's in excess of $1 million, or average BAC's in excess of $500,000 for any month 12/1/81 - 3/21/82	Branches identified as possibly engaging in excessive drawdowns by Hutton's outside counsel	Branches identified as possibly engaging in excessive drawdowns by W. Sullivan	Branches identified in Counts 101-2,000 of information	Branches identified as being in a chain by either Hutton's outside counsel or DOJ or by Hutton's internal auditors
Oneonta, NY	(J17)								X
Orlando, FL	(R26)			X					
Palm Beach, FL	(R28)			X					
Palm Springs, CA	(L66)				X				
Palo Alto, CA	(K14)				X				
Paramus, NJ	(A21)				X			X	
Peoria, IL	(F20)								X
Pepper Pike, OH	(A31)							X	X
Philadelphia, PA	(A09)		X	X	X		X	X	X
Pittsburgh, PA	(A44)	X	X	X	X		X	X	X
Pompano Beach, FL	(R16)			X			X	X	
Portland, ME	(J31)								X
Portland, OR	(K17)				X		X	X	
Portsmouth, NH	(J47)								X
Potsdam, NY	(J11, A38)								X
Providence, RI	(J32)						X		X
Provo, UT	(H16)	X			X		X	X	X
Pueblo, CO	(H10)				X				X

Branches where it is suspected that chaining or overdrafting may possibly have occurred. This is not a list of branches where illegal conduct has been confirmed.

Branches where it is suspected that chaining or overdrafting may possibly have occurred. This is not a list of branches where illegal conduct has been confirmed.		Branches with $10,000 in general ledger bank balance interest for any month in 1982	Branches with $30,000 in general ledger interest for any month in 1981	Branches writing 10 or more Chemical Bank BRC's, BRC's in excess of $1 million, or average BRC's in excess of $500,000 for any month 1/1/80 - 5/31/81	Branches writing 10 or more United States Trust Company BRC's, BRC's in excess of $1 million or average BRC's in excess of $500,000 for any month 12/1/81 - 3/21/82	Branches identified as possibly engaging in excessive drawdowns by Hutton's outside counsel	Branches identified as possibly engaging in excessive drawdowns by W. Sullivan	Branches identified in Counts 101-2,000 of information	Branches identified as being in a chain by either Hutton's outside counsel or DOJ or by Hutton's internal auditors
Riverhead, NY	(A06)				X		X		X
Rochester (Federal Plaza), NY	(J13)			X	X		X		
Rochester (Midtown), NY	(J14, A42)		X		X		X		X
Rock Island, IL	(F16)								X
Rockford, IL	(F45)								X
Roswell, NM	(H78)		X				X		X
Sacramento, CA	(K54)				X				
St. Charles, MO	(C12)				X			X	
St. Louis, MO	(C10)	X		X	X		X	X	X
St. Paul, MN	(F24)								X
St. Petersburg, FL	(R34)			X				X	
Salem, MA	(J29)								X
Salt Lake City, UT	(H15)				X		X	X	
San Antonio, TX	(N92)				X		X	X	X
San Diego, CA	(L59)		X		X		X	X	
San Francisco, CA	(K50)			X					
San Jose, CA	(K52)				X		X	X	
Santa Monica, CA	(L71)				X		X	X	

Branches where it is suspected that chaining or overdrafting may possibly have occurred. This is not a list of branches where illegal conduct has been confirmed.

		Branches with $10,000 in general ledger bank balance interest for any month in 1982	Branches with $30,000 in general ledger interest for any month in 1981	Branches writing 10 or more Chemical Bank BRC's, BRC's in excess of $1 million, or average BRC's in excess of $500,000 for any month 1/1/80 - 3/31/81	Branches writing 10 or more United States Trust Company BRC's, BRC's in excess of $1 million or average BRC's in excess of $500,000 for any month 12/1/81 - 3/21/82	Branches identified as possibly engaging in excessive drawdowns by Hutton's outside counsel	Branches identified as possibly engaging in excessive drawdowns by W. Sullivan	Branches identified in Counts 101-2,000 of information	Branches identified as being in a chain by either Hutton's outside counsel or DOJ or by Hutton's internal auditors
Sarasota, FL	(R41)			X				X	
Scottsdale, AZ	(H75)	X	X		X		X	X	
Seattle, WA	(K35)		X	X	X		X	X	X
Shreveport, LA	(N40)	X	X	X			X	X	X
Southfield, MI	(F06)	X	X		X		X	X	X
Spokane, WA	(K19)				X				
Springfield, MA	(J24)								X
Stamford, CT	(A49)	X			X		X	X	X
Stockton, CA	(K05)				X				
Strafford, PA	(A25)	X			X		X	X	X
Stuart, FL	(R37)			X					
Sun City, AZ	(H13)				X				
Syracuse, NY	(J16)				X				X
Tampa, FL	(R40)		X	X	X			X	
Titusville, FL	(R43)				X				
Torrance, CA	(L08)				X			X	
Traverse City, MI	(F07)				X			X	X
Troy, MI	(F08)				X				X

Branches where it is suspected that chaining or overdrafting may possibly have occurred. This is not a list of branches where illegal conduct has been confirmed.

		Branches with $10,000 in general ledger bank balance interest for any month in 1982	Branches with $30,000 in general ledger interest for any month in 1981	Branches writing 10 or more Chemical Bank BRC's, BRC's in excess of $1 million, or average BRC's in excess of $500,000 for any month 7/1/80 - 5/31/81	Branches writing 10 or more United States Trust Company BRC's, BRC's in excess of $1 million or average BRC's in excess of $500,000 for any month 12/1/81 - 3/21/82	Branches identified as possibly engaging in excessive drawdowns by Hutton's outside counsel	Branches identified as possibly engaging in excessive drawdowns by W. Sullivan	Branches identified in Counts 101-2,000 of information	Branches identified as being in a chain by either Hutton's outside counsel or DOJ or by Hutton's internal auditors
Tucson, AZ	(H76)		X		X		X		X
Tyler, TX	(N84)								X
Universal City, CA	(L74)				X			X	
Waco, TX	(N02)			X				X	X
Washington (Washington Sq.), DC	(C16)	X	X	X	X		X	X	
Washington (Eye St.), DC	(C18)	X	X	X	X	X	X	X	
Wausau, WI	(F11)								X
White Plains, NY	(A24)			X	X				X
Wichita, KS	(C26)							X	X
Wichita Falls, TX	(N85)					X		X	X
Wilkes Barre, PA	(A50)				X			X	X
Williamsport, PA	(A14)				X	X	X	X	
Winston-Salem, NC	(R31)			X					
Wyomissing, PA	(A13)	X	X		X	X	X	X	X

KING & SPALDING
2500 TRUST COMPANY TOWER
ATLANTA, GEORGIA 30303
404/572-4600

TELEX: 54-2817
TELECOPIER: 404 [illegible]
[illegible]
CABLE: TERMINUS

1730 PENNSYLVANIA AVENUE, N. W.
SUITE 1200
WASHINGTON, D. C. 20006
202/737-0500

September 6, 1985

The Honorable William J. Hughes
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Hughes:

It was good to see you briefly last evening.

I will be glad to do what I can to assist you in the Hutton matter. I noticed in the paper that you may call on me to testify, and this will serve to assure you that I will be glad to testify at your convenience.

All good wishes.

Sincerely yours,

Griffin B. Bell

GBB/jld-wdc
bcc: Terry Adamson
delivered by hand 9/6/85

EXHIBIT C

GRIFFIN BELL'S RESPONSES TO QUESTIONS OF CHAIRMAN THURMOND

QUESTION ONE: There has been some criticism of your report. In fact, it has been characterized as an attempt at "damage control" by E. F. Hutton. What is your response to that criticism?

ANSWER: The only criticism that I have heard of my report in the Hutton matter has been from Congressman Hughes of New Jersey who is head of the House Judiciary Subcommittee on Crime. His Committee has not published a report, so I do not know just which members are joining with him in the criticism. His criticism is in the form of a staff report containing a good deal of nitpicking as to the Hutton report.

I was prepared to answer every criticism, paragraph by paragraph, when I appeared before the Senate Committee last week on May 8, 1986, but I was not asked any questions despite the fact that Congressman Hughes released his criticisms on the eve of the Senate hearing.

The most telling fact, however, is that Congressman Hughes has refused to permit me to testify before his own Committee, although I volunteered to him in person to do so and also in writing.

The phrase "damage control" is that of Congressman Hughes. It would have been prudent for Hutton to exercise "damage control" by having an independent investigation made of its problems. I acted as that independent investigator and am satisfied that I acted independently. I was paid by Hutton to conduct the investigation regardless of the outcome. My independence and integrity are not and have never been for sale.

QUESTION TWO: the Congressional investigation in the House Judiciary Subcommittee on Crime has been extensive and has produced criticism of your report. Are you aware of any information the Subcommittee has which is not in your report, or which is contradictory to your report?

ANSWER: In addition to what I have said in response to Question One, I am not aware of any information that the House Subcommittee has which is not in my report or which is contradictory to my report.

QUESTION THREE: Certainly, you are one of the experts on the E. F. Hutton case. Did you testify before the House? What are your views on that investigation? (I want to note at this point that Senator Biden has included you as a witness from the time we began planning these hearings.)

ANSWER: As I said in response to Question One, I was not permitted to testify before the House Subcommittee. I do not know just what the focus of that subcommittee is, although I believe they have said from the beginning that they were doing an oversight investigation of the Department of Justice.

I greatly appreciate the fact that Senator Biden included me as a witness in the Senate.

QUESTION FOUR: Although your report did not include a review of the plea agreement, as a former Attorney General, would you comment on the Justice Department investigation of E. F. Hutton?

ANSWER: Based on my own Hutton investigation, I am of the opinion that the Justice Department investigation of the Hutton matter was thorough and was based on good investigative practices. There was a good deal of immunity given, but it was in an effort to trace the wrongdoing upward from the bottom, and it was simply impossible to implicate those at the top in the prosecutorial effort. My own investigation causes me to believe that the Department did not leave any stone unturned in its investigation.

QUESTION FIVE: We all understand that Congress has a legitimate oversight function, would you comment on the impact that an overzealous Congressional investigation could have on Justice Department prosecution policy and especially on line prosecutors?

ANSWER: Congress does have a legitimate oversight function, and it is entirely proper to employ the resources of the Congress in overseeing the activities of the Department of Justice.

It is especially important, however, as Congress McCollum, a member of Congressman Hughes' subcommittee, testified in the Senate, not to become overzealous in an oversight hearing lest there be a chance that the prosecutorial function is chilled or the prosecutorial discretion is chilled by the thought that Congress is looking over its shoulder at whatever the prosecutors are doing in the exercise of their discretion.

President Carter once directed me to bring a prosecution, and I had to decline on double jeopardy grounds. He thought that the question was close because of the difference between a state and federal investigation and that I should prosecute. He told the press that he could discharge me as Attorney General but he could not exercise the prosecutorial discretion for me and that he had decided not to discharge me. This is a good example of drawing the line between what Congress needs to do in its oversight function and being careful not to chill the prosecutor's discretion.

QUESTION SIX: Also in your capacity as a former Attorney General, could you give your views on prosecutorial discretion as it was exercised in the E. F. Hutton investigation?

ANSWER: The answer to this question is essentially what I have said in answer to Question Five.

RESPONSE OF GRIFFIN B. BELL
TO STATEMENT OF
CONGRESSMAN WILLIAM J. HUGHES
BEFORE THE SENATE COMMITTEE ON THE JUDICIARY

On May 7, 1986, Congressman William J. Hughes, Chairman of the House Judiciary Subcommittee on Crime, provided a Statement to the Senate Committee on the Judiciary and attached a "Staff Analysis of `The Hutton Report'[1] by Griffin Bell," both of which attack my investigation of E.F. Hutton & Company Inc. ("Hutton"). Chairman Hughes' Committee has not published a final report, so I do not know whether other members of his Committee support his criticism of my investigation.

I offered to appear before the House Judiciary Subcommittee on Crime, but was never called to testify. I conveyed this offer in person to Chairman Hughes on September 5, 1985, and in writing on September 6, 1985. (A copy of the September 6, 1985 letter to Chairman Hughes is attached as Exhibit 3.) I appeared before the Senate Committee on the Judiciary on May 8, 1986 to answer questions about my investigation of Hutton. Although Chairman Hughes was called as a witness, he declined to appear, but rather sent the Statement, and attached Staff Highlights and Analysis to the Senate Judiciary Committee.

I have prepared the attached response to Chairman Hughes' Statement, Staff Highlights, and Staff Analysis.

CHAIRMAN HUGHES STATEMENT:

Last May, E.F. Hutton & Company, Inc. pleaded guilty to 2000 counts of mail and wire fraud in the Middle District of Pennsylvania. No individuals were charged with the wrongdoing. Following a public outcry because of the Department's failure to seek to hold any individuals accountable, Hutton retained Griffin Bell to investigate the circumstances surrounding its guilty plea.

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[1] The complete title is "The Hutton Report - A Special Investigation into the Conduct of E.F. Hutton & Company Inc. that Gave Rise to the Plea of Guilty Entered on May 2, 1985," hereinafter referred to as "The Hutton Report."

Hutton has portrayed Judge Bell's report as that of an independent investigator. It has relied on his report in making decisions on how to treat individual Hutton officers and employees implicated in the wrongdoing, and has provided the report to various State agencies with authority to revoke the licenses of those individuals and of Hutton itself. In essence, Hutton asked Judge Bell to do the job the Department of Justice never did -- that of making a determination of individual accountability within the Company for the criminal acts.

Judge Bell's report is nothing more than an attempt at "damage control" by Hutton. No matter how they attempt to "dress it up" as an independent and objective assessment, it falls far short of that goal. First, Judge Bell is not independent. He is employed by Hutton and his mission was set forth by Hutton. Hutton has claimed attorney-client privilege on documents subpoenaed by the Subcommittee on Crime, yet has shared those documents with Judge Bell and has refused to make Judge Bell's working papers public. Although Judge Bell has compared himself to an English "royal commission," he was retained by Hutton, paid by Hutton, and is accountable to Hutton.

BELL RESPONSE:

I believe that this attack on my independence is scurrilous. I would not compromise my professional reputation in any such manner. My integrity is not for sale. My law firm and I were retained and paid by Hutton. I was accountable to Hutton only in the sense that I performed my responsibilities in a professional manner. Hutton understood and agreed from the beginning that I was to have complete independence with respect to the investigation I conducted and with respect to the report and recommendations I would make.

I met with the Executive Committee of the North American Securities Administrators Association ("NASAA") in June in Atlanta and promised to make my final report available to them. I later addressed the annual meeting of the NASAA in Calgary. After that meeting, we made available on request to these state securities regulators packages of documents relating to Hutton activities in their respective states and a computerized summary of our investigation in their respective states. At the request of state securities regulators in Georgia, West Virginia and Connecticut, we also furnished attorneys to those states to provide information on our investigation.

As to the statement that "Hutton has claimed attorney-client privilege on documents subpoenaed by the Subcommittee on

Crime yet has shared those documents with Judge Bell and has refused to make Judge Bell's working papers public," I have never received a request from the Judiciary Subcommittee on Crime to produce my "working papers." We have produced to the SEC, with Hutton's approval, our interview notes. It is totally unfair to accuse me of not providing my papers when a request was never made to me and I was never called as a witness by the Judiciary Subcommittee on Crime.

CHAIRMAN HUGHES STATEMENT:

Judge Bell's investigation was well financed and well staffed; he had 14 lawyers and 4 paralegals working for almost 4 months before he released his report. His instructions were to take all the time he needed to complete his investigation.

The staff of the Subcommittee on Crime, which I chair, has analyzed Judge Bell's report and has found that, despite Judge Bell's mandate and resources, there are a number of major weaknesses in it. I have appended to my statement this comprehensive analysis, but intend here to comment on just a few major points.

As in any investigation, Judge Bell was confronted with a number of conflicting stories from various Hutton employees. In many key instances, he chose either not to resolve those conflicts or to resolve them without explanation or supporting evidence. For example, according to Bell, John Pearce, the Bethesda, and then St. Louis branch manager, "claims that the St. Louis/Bethesda drawdown was approved by Michael Wallace, the Central Regional Operations Manager. Wallace denies this assertion." No attempt was made to resolve this inconsistency. He did, however, conclude that certain of the individuals were responsible for the criminality and recommend sanctions against them. Ultimately, Judge Bell concluded that the higher level employees were to be believed because, in general, the harshest sanctions were meted out to the lower level employees. In the example cited above, Judge Bell recommended that John Pearce be fined $25,000 to $50,000, be placed on probation for 1 year, and have a letter of reprimand placed in his personnel file. Bell did not recommend any punishment for Wallace.

BELL RESPONSE:

There are no "major weaknesses" with the findings of my investigation of Hutton's conduct that gave rise to the plea of guilty. Despite these unfounded allegations, neither Hughes nor his staff has offered any facts or evidence that would make our findings different. I am not aware of any facts or evidence discovered since my report that would have made our findings any different if we had taken more time. Obviously, there was no "comprehensive analysis" by the Hughes Staff. The Hughes Staff ignored its oversight jurisdiction of the Department of Justice's prosecution of Hutton and did not conduct its own independent investigation. Instead, the Staff attempted to pick holes in my investigation and The Hutton Report. The ranking Republican of the House Subcommittee on Crime, the Honorable Bill McCollum from the State of Florida, appeared before the Senate Committee on the Judiciary on May 8, 1986 and admonished the Subcommittee for criticizing nonpolitical prosecutors for their handling of the Hutton investigation.

As to any conflict between statements of Mr. Pearce and Mr. Wallace, among others, it is true that I was confronted with a number of conflicting stories from various Hutton employees and reported the conflicts in my report. The Conclusions and Remedies section of The Hutton Report, pages 168-182, provides my findings as to individual responsibility.

Hughes ignores the fact that I did not make any recommendations to Hutton regarding Mr. Pearce's participation in chaining. There was no evidence that Mr. Wallace knew about Mr. Pearce's excessive overdrafting at the Bethesda, Maryland (C32) and St. Louis, Missouri (C10) branches. In fact, Mr. Pearce admitted when I interviewed him that he didn't know whether Mr. Wallace knew about the excessive overdrafting. The sanction recommended for Mr. Pearce was for the excessive overdrafting that Mr. Pearce directed while he was the branch manager in Bethesda, Maryland (C32) and St. Louis, Missouri (C10).

The criticism that "the harshest sanctions were meted out to the lower level employees" and claims that I decided the higher level employees were to be believed over the lower level employees, is wrong. Hughes cites Mr. Pearce as an example because I recommended that Mr. Pearce be fined and reprimanded, while not recommending any punishment for Mr. Wallace. Mr. Wallace was a Regional Operations Manager and would not be considered a high level employee. Hughes neglects to mention that we recommended that Mr. Wallace's superior, Ernest Dippel, be reprimanded. Mr. Dippel was a Regional Sales Manager, who was a

Regional Vice-President at the time of his recommended reprimand and would be considered a high level employee.

The criticism that I decided higher level employees were to be believed over lower level employees is also inaccurate because when we were investigating the activities of branch and regional managers we interviewed branch cashiers and operational employees to obtain information on the branch manager's involvement in the daily drawdown. We relied on the statements provided by the branch cashiers, who would be considered among the lower echelon administrative employees in the Hutton branch offices.

As to any criticism that the harshest sanctions were "meted out to the lower level employees," I doubt that Thomas P. Lynch, Executive Vice-President and Managing Director, and Thomas W. Rae, General Counsel and head of Legal and Compliance, would be considered lower level employees. The largest category of employees that we recommended for discipline were the branch managers. Branch managers cannot be considered lower level employees in view of the substantial incomes they make and the responsibilities given to them by the company.

CHAIRMAN HUGHES STATEMENT:

Judge Bell's investigation failed to deal with all relevant facts. For example, he simply ignored over 60 branches involved in illegal chaining -- branches identified by the Department of Justice and by Hutton itself. In this way, it appeared that the scope of Hutton's wrongdoing was much less than it actually was. Furthermore, while there were 25 chains identified by the Department, Judge Bell acknowledged and dealt with only 15 of those chains.

BELL RESPONSE:

Evidently, neither Hughes nor his staff has read my report, which specifically states that all 25 chains identified by the Department of Justice were investigated.[2] Page 56 of The Hutton Report discusses 15 of the 25 chains; a portion of the 10 remaining chains constituted subparts of the 15 chains that were not discussed. Chains that were not identified on page 56 were either dealt with generally or we found that the chain was not created for an improper purpose.

Although we investigated the 25 chains identified by the Department of Justice, we did not investigate each and every branch accused of chaining or which we identified as having possibly been engaged in chaining unless it was identified in a count in the Information or met two criteria establishing a high correlation between above normal interest income profits and overdrafting banking practices of the branch. Our analysis showed that it was unlikely that a chain was created for the purpose of making high interest profits unless it met the criteria set forth above. We also believed that it was not necessary to interview every branch accused of chaining because we had obtained substantial information from branches in each region to determine the involvement of regional personnel in chaining. With the exception of the St. Louis/Bethesda/Seattle chain, we found that regional personnel were responsible for establishing chaining activities.

CHAIRMAN HUGHES STATEMENT:

According to Judge Bell, Hutton should not have pleaded guilty to all 2000 counts. For example, he alleged that in at least one instance charged by the Department, involving the Hutton branch in Louisville, Kentucky, there was no fraud and no criminal wrongdoing because the bank was aware of Hutton's activities. The facts are otherwise. Hutton's bank in Louisville was not aware of Hutton's practices, did not agree to them, and after several months of attempting to get Hutton to stop overdrafting, threatened to close the account. Judge Bell cited as support a letter from the bank; however, we have learned that the language of the letter was suggested by Hutton's Louisville branch manager, and that bank officials would have been more complete if they had fully understood the purpose of the letter.

---

[2] Pages 37 and 38 of The Hutton Report state:

> The chains identified by the Department of Justice during the plea-taking on March 2, 1985 and those identified by Hutton's outside counsel and internal auditors were used to identify branches to be interviewed. A total of twenty-five (25) chains within the Hutton system were identified by the Department of Justice, and each of these chains were investigated.

BELL RESPONSE:

The only reference to whether Hutton should have pleaded guilty is found in footnote 39 at page 71 of The Hutton Report in which I said there were "serious questions" as to whether Hutton should have pleaded guilty to all counts of the Information.

I am attaching to this response, as Exhibit 1, a copy of an internal bank memorandum dated November 13, 1981, that shows that the First National Bank of Louisville closely analyzed and monitored the Hutton account from the time it was opened in September of 1981. Also attached, as Exhibit 2, is a December 21, 1981 letter from an officer of the First National Bank of Louisville to the assistant manager at the Hutton branch in Louisville, enclosing analyses for the months of October 1981 and November 1981. The letter also states that the account will be reviewed in January and July of each year to determine whether a net service charge would be made on the average daily collected balance.

CHAIRMAN HUGHES STATEMENT:

The report attempts to minimize the harm to the banks where Hutton illegally overdrafted. Judge Bell asserted that most of these banks were either aware of Hutton's conduct or consented to it. This is wrong. Many of Hutton's banks became aware of the overdrafting and demanded that Hutton cease the practice and compensate them for their losses. I do not understand how Judge Bell can call this consent. It does not follow that, just because the criminal has returned the illegally gotten gains, there has been no crime.

BELL RESPONSE:

This statement is difficult to respond to because it doesn't make sense. Hughes, as a former prosecutor, should be aware that it would be difficult to obtain a fraud conviction when the bank knew what was going on and did not close the Hutton account. As to "illegally gotten gains," a prosecutor would have to prove who owned the float. This is a question that is unresolved in the American banking system today.

CHAIRMAN HUGHES STATEMENT:

The Department of Justice charged, and Hutton pleaded guilty to, 2000 counts of mail and wire fraud, perpetrated by 113 offices. Judge Bell, however, exonerated 28 of these offices, representing 168 counts and $128 million based on interviews and his review of documents; he exonerated another 55 offices, representing 656 counts and $1.215 billion, because the office personnel denied overdrafting in amounts beyond those mandated by the drawdown worksheet. One of the branches -- Washington, D.C. "Eye Street" -- was responsible for 97 counts and $436 million in transactions. Apparently Judge Bell simply accepted the employees' statements and did not independently evaluate them. In addition, he failed to deal at all with 10 offices, representing 176 counts and $623 million.

BELL RESPONSE:

Chairman Hughes has not listed the 10 offices that he claims were omitted from The Hutton Report. In the Staff Analysis, a claim is made that 4 branches and 6 regions were omitted. All regional activity was discussed on pages 72-76 of The Hutton Report. Although the Staff Analysis does not identify the 4 branches that were allegedly omitted, our review indicates that the only Hutton offices not discussed in The Hutton Report that were identified in a count in the Information were N61, N93 and A32. A32 was not a retail branch account, but was an account in New York for Corporate Executive Services. N61 was a branch in Houston, Texas that is no longer in existence. N93 was a branch in Greenway, Texas that is no longer in existence. There were 3 counts in the Information for A32, 5 counts for N61, and 2 counts for N93.

As to criticism that we exonerated branches when the Hutton employees denied overdrafting, this is not what occurred. Before we interviewed Hutton employees at a branch, we reviewed the branch's banking activities by analyzing the branch's cash receipts, blotters and bank statements in addition to any other information we had obtained about the branch's interest profits and use of BRCs. We also interviewed the branch managers, branch cashiers and operations personnel, but if we did not find conclusive evidence that an individual directed excessive overdrafting, we did not recommend discipline of an unidentifiable person. Our investigation focused on individual responsibility. Perry Bacon admitted overdrafting at the Alexandria, Virginia branch (C20) and Washington, D.C. Eye Street branch (C18). There was no evidence that any other individual participated in wrongdoing at C18. In retrospect, it would have been appropriate to leave C18 off the exoneration list (Exhibit 16 to the Appendix), given the admissions of Mr. Bacon.

CHAIRMAN HUGHES STATEMENT:

The branch manager of the Washington, D.C. "Eye Street" Office was Perry Bacon, one of the most egregious offenders within Hutton. Mr. Bacon managed the Alexandria branch as well, where Hutton also overdrafted in enormous amounts. In approximately one year, beginning in early 1981, bank accounts maintained by Mr. Bacon for his two branches were overdrafted by a total of more than $1 billion. Hutton Chairman Fomon, relying on Judge Bell's report, described Mr. Bacon as "`responsible for enacting and supervising a sophisticated scheme of overdrafting the Alexandria branch bank account,' including the drawing down of `bogus' deposits. Your conduct, he concluded, `was such that no reasonable person could have believed that this conduct was proper.'" Mr. Bacon was granted immunity by the Department of Justice, and so was never prosecuted. Judge Bell recommended sanctions against Mr. Bacon: a $25,000 to $50,000 fine, a letter of reprimand, and one year's probation. Instead, Hutton negotiated Mr. Bacon's termination from the Company. According to Mr. Fomon, Mr. Bacon never paid his fine because, as Judge Bell recommended, if an employee left the Company, payment of the fine was unnecessary. Even if Mr. Bacon had paid his fine, however, it would hardly have constituted punishment. Hutton agreed, as part of its severance agreement, to pay Mr. Bacon $630,000 plus contingencies. It also agreed to help Mr. Bacon establish a new business. Finally, the Company agreed not to sue Mr. Bacon, a commitment from which it is released if Mr. Bacon fails to cooperate "with the Company" in any investigations of Hutton's wrongdoing. When I asked Mr. Fomon for an explanation of this payment, his response was that Hutton makes payments to all of its employees who are terminated from the Company, and this one was no different. To Mr. Fomon, it may be "business as usual;" to others -- like me -- it looks like "hush money."

The inevitable result of the Justice Department's failure to prosecute individuals is that it permitted Hutton to investigate itself, to mete out its own punishment in a manner designed to promote the interests of the Company, not of justice, and to use its own conclusions in negotiating with the various states deciding whether to revoke the Company's license. In general, Hutton as a corporation has not been severely punished by the states. In exchange for protecting its license, the Company has bargained away the rights of its individual employees, and their opportunities to do business within those states. In nearly every instance, the states have relied on the Bell report in punishing the individuals and in concluding that the Company -- because it has punished the individuals itself and has taken steps toward "rehabilitation" -- should not be further penalized.

It is the Department of Justice that ultimately should have sought a determination of individual liability for Hutton's wrongdoing. By its failure to do so, the Department left Hutton the opportunity to shape its own inquiry and conclusions in the light most favorable to the Company.

BELL RESPONSE:

The majority of the remarks contained in the last two pages of the Hughes Statement deal with actions taken by Hutton after I completed my investigation. I have not participated in any settlements by Hutton with any employee. My knowledge of the state investigations has come from questions that we received from state securities regulators concerning documents or information we had concerning Hutton activities in that particular state. Upon the request of state securities regulators in West Virginia, Connecticut and Georgia, we furnished attorneys to provide information about our investigation in those states.

The last paragraph of the Statement criticizes the Department of Justice for not determining "individual liability for Hutton's wrongdoing." It is my opinion that the Department of Justice conducted a comprehensive investigation. The Department granted immunity to many individuals, an effort frequently used by experienced prosecutors to trace the wrongdoing upward from the bottom. As the investigation developed, however, the evidence obtained by the Justice Department was apparently not enough to prove any wrongdoing by high officials. Eventually, the Justice Department decided to enter into a plea agreement with E.F. Hutton whereby no individuals were indicted for any wrongdoing.

RESPONSE OF GRIFFIN B. BELL

TO CONGRESSMAN WILLIAM J. HUGHES

STAFF HIGHLIGHTS OF BELL REPORT

WEAKNESSES, STATE ACTIONS, AND PEARCE SUIT

o LACK OF SUPPORT FOR CONCLUSIONS: A consistent problem throughout the Bell report is his failure to provide details in support of his assertions, so that the reader can verify them.

BELL RESPONSE:

The Hutton Report contains 183 pages of text with 123 footnotes and 72 Exhibits in the Appendix to The Hutton Report. If Chairman Hughes wanted more details to "verify" the report, he should have called me to testify.

o "HARM TO BANKS EXAGGERATED": Bell asserts that estimates of restitution due, and thus harm to, the banks are exaggerated and that most of Hutton's banks were satisfied customers. He includes within this category of "satisfied" banks those that discovered the overdrafting and that demanded compensation. Obviously, our investigation shows that most of these banks were not satisfied and, in fact, many of them threatened to close Hutton's account if the overdrafting was not stopped. Bell says there were only a few banks that did not discover Hutton's activities, which we also dispute. Bell bases his claim that restitution estimates have been exaggerated on the small number of banks that applied for it by the deadline. He ignores the fact that many banks feel applying for restitution is futile, too time-consuming or expensive, and that many banks have already extracted compensation for their losses outside the restitution program.

BELL RESPONSE:

As of May 8, 1986, the banks with which Hutton had accounts had only made claims totaling $3.5 million under the bank restitution program. Of those claims, Hutton has paid out $2.5 million to banks. Initially, Hutton had allocated $8 million in reserve for bank restitution claims. There may be reasons that a bank with a valid claim for restitution would not apply; however, that bank could be subjected to a shareholder derivative suit for failure to collect under the restitution program. My attorneys interviewed bank officers at over 60 banks and found that most banks monitor their accounts, including Hutton's accounts, to assure that the accounts are profitable for the bank. Apparently, the Staff Analysis is quibbling over the definition of "satisfied."

o JUSTIFICATION FOR CHAINS: Bell claims that much of the chaining was "justifiable," in that it served the "legitimate" purposes of convenience and improving availability of funds. Presumably, Bell even considered chains set up to create float to be justifiable if one of these other purposes was also present.

BELL RESPONSE:

I have never said nor does my report reflect a statement that "chains set up to create float" would be "justifiable if one of these other purposes [convenience and improving availability] was also present." Page 56 of The Hutton Report specifically states that "[c]onvenience chains were not intended to give Hutton any economic advantage" and that availability chains were created to "normalize" the presentment and collection process.

o NUMBER OF CHAINS: DOJ indicated there were as many as 50 chains. Bell purports to investigate only 25, and makes conclusions about only 15. He does not disclose what happened to the other 10, or why he did not investigate the other 25. Using Bell's own appendices to the report, however, Bell has apparently ignored his own appendices and explained the involvement of only 56.

BELL RESPONSE:

We investigated the conduct that gave rise to Hutton's plea of guilty. In that regard, we investigated each of the 25 chains identified by the Department of Justice at the May 2, 1985 plea taking. We have never been told by the Justice Department or any other person that any chains, other than the 25 identified at the plea taking, were related in any way to the plea or were created for improper purpose. Furthermore, the Justice Department did not identify for us any chains other than the 25 that were mentioned at the plea taking.

My report specifically states that all 25 chains identified by the Department of Justice were investigated. (See pages 37-38 of The Hutton Report.) Page 56 of The Hutton Report discusses 15 of the 25 chains identified by the Department of Justice; a portion of the 10 remaining chains constituted subparts of the 15 chains that were discussed. Chains that were not identified on page 56 were either dealt with generally or we found that the chain was not created for an improper purpose.

o PLEA TO CERTAIN COUNTS A MISTAKE: Even though Hutton pleaded guilty to many counts involving the First National Bank of Louisville, Bell asserts that no fraud occurred because the bank was aware of Hutton's activities. In our conversations with the bank, it became clear that the bank discovered the overdrafting, demanded that it stop, and was promised that it would. After several months of unfulfilled promises, the bank threatened to close the account.

The Louisville branch manager asked the bank to write a letter to Bell, which Bell contends shows that the bank knew about and in essence consented to the activities. In fact, the letter only says that the bank knew about the activities, not that it consented. In context, the letter is extremely misleading. The branch manager suggested the letter's language to the bank; bank officials have told us that they would have been more complete if they had understood the context in which it was to be used.

BELL RESPONSE:

I am attaching to this response, as Exhibit 1, a copy of an internal bank memorandum dated November 13, 1981, which shows that the First National Bank of Louisville closely analyzed and monitored the Hutton account from the time it was opened in September of 1981. Also attached, as Exhibit 2, is a December 21, 1981 letter from an officer at the First National Bank to the assistant manager at the Hutton branch in Louisville enclosing analyses for the months of October and November 1981. The letter also states that the Hutton account will be reviewed in January and July of each year to determine whether a service charge would be made on the average daily collected balance. These documents support a finding that the bank knew about the overdrafting by the Hutton branch in Louisville.

o CONFLICTING WITNESS STATEMENTS: In a number of instances, Bell cites conflicts between statements of various Hutton employees, but either makes no attempt to resolve those conflicts, or resolves them without any explanation of how he reached his conclusions. Often, those resolutions are in favor of the higher level employee. Bell recommends sanctions against some of the branch and regional employees; ultimately, he must have concluded that the higher level employes [sic] who the branch and regional officers claimed approved their activities, but who denied it, were to be believed.

BELL RESPONSE:

It is inaccurate to state that I concluded that higher level employees were to be believed over lower level employees. Moreover, generalizations regarding the individual employees discussed in The Hutton Report are difficult to make. We relied on statements by branch cashiers and operations personnel, who would be considered among the lower level administrative employees in the Hutton system. We also recommended sanctions for regional personnel and high level employees in New York, so it is likewise inappropriate to generalize that I often resolved conflicts in favor of higher level employees. I doubt that Thomas P. Lynch, Executive Vice-President and Managing Director, and Thomas W. Rae, General Counsel and head of Legal and Compliance, would be considered lower level employees. It is doubtful that the branch managers that were sanctioned would be considered lower level employees in view of their substantial salaries and responsibilities given to them by the company.

o THOROUGHNESS OF INVESTIGATION: Robert Fomon instructed Bell to take as much time as necessary to complete the investigation. Subsequently, however, Bell cut corners on the investigation and cut the investigation short. For example, he abandoned his announced intention to interview all relevant branch personnel before moving on to the regional level, and closed the investigation and moved to final judgment despite the fact that important information was available but not fully evaluated. This was apparently done in order to have the report available before federal and state regulatory bodies acted. While this is understandable, it would appear to have been better to also scale back the scope of his conclusions commensurate with the curtailment of the evidentiary phase. Perhaps the most fundamental flaw of the Hutton report is its exoneration of branches and personnel based solely upon their denials. (Noted and discussed elsewhere in this analysis.) It may be that this error could have been eliminated or reduced had Bell taken the time to complete the investigation, or scale back his findings accordingly.

BELL RESPONSE:

My investigation was thorough and complete. Mr. Fomon, in his May 28, 1985 letter to me, stated, "[i]t is our hope that you will proceed as expeditiously as possible, but take as long as is required thoroughly to complete your investigation." I personally set a cut-off date of Labor Day weekend because I believed that my lawyers could complete the investigation by that date. We did not cut corners on the investigation and no information has since been brought to my attention that would have made our findings any different if we had taken more time. We did not exonerate personnel based solely upon their denials, but because there was no conclusive evidence of wrongdoing by a particular individual.

o INVESTIGATIVE CRITERIA: Excluding the branches identified in the Information counts, the investigative criteria used by Bell ultimately identified only one other branch -- Bakersfield, California -- where Bell found that excessive overdrafting occurred. Furthermore, Bell failed to find anyone responsible for those activities because the branch claimed the regional interest specialist instructed the branch to overdraft, the specialist declined to be interviewed, and other regional personnel contacted denied giving such instructions.

BELL RESPONSE:

In addition to identification by a count in the Information, we used the following six criteria, which were discussed on pages 39-44 of The Hutton Report, to identify branches that engaged in excessive overdrafting:

1. Branches with $10,000 in general ledger bank balance interest for any month in 1982.
2. Branches with $30,000 in general ledger interest for any month in 1981.
3. Branches writing 10 or more Chemical Bank BRCs, BRCs in excess of $1 million or average BRCs in excess of $500,000 for any month 1/7/80-5/21/81.
4. Branches writing 10 or more United States Trust Company BRCs, BRCs in excess of $1 million or average BRCs in excess of $500,000 for any month 12/1/81-3/21/82.
5. Branches identified as possibly engaging in excessive overdrafting by Hutton's outside counsel.
6. Branches identified as possibly engaging in excessive drawdowns by William Sullivan.

These criteria assisted us in identifying many branches that might have engaged in excessive overdrafting but were not listed in a count of the Information. The criteria were developed separate and apart from any criteria that were developed by the government. These independent criteria identified only one branch not listed in a count of the Information as having engaged in excessive overdrafting was Bakersfield, California (L21). We interviewed the former branch cashier, branch manager and branch operations manager at the Bakersfield branch. The branch cashier, who had left Hutton's employment in May 1984, stated that she was directed by Mark Willets, the Regional Interest Specialist, to add a set dollar amount to the daily drawdown. There was no evidence that any other Hutton employee at the Bakersfield branch had directed the branch cashier to exceed the drawdown formula.

- <u>EXONERATION OF BRANCHES</u>: Twenty-eight offices, representing 168 counts and $128 million, were exonerated by Bell "[b]ased on the available financial documents and interviews of branch personnel...."

Fifty-five offices, representing 656 counts and $1.215 billion, were exonerated by Bell because "the personnel at these branches denied that they overdrafted in amounts greater than that required by the drawdown formula and worksheet." Bell concludes, "In the absence of evidence sufficient to establish that these branches engaged in excessive overdrafting ... they also should be exonerated." One of these branches -- Washington (Eye Street), D.C. -- was responsible for 97 counts and $436 million in transactions.

Ten offices -- 4 branches and 6 regions -- representing 176 counts and $623 million were not listed and dealt with in the Hutton report.

The Bell report, in discussing Perry Bacon's activities at the Alexandria branch, states, "Bacon admitted that the branch drew down `not only deposits plus anticipated deposits, but also bogus deposits.'" Bell thus concluded that the Alexandria branch had engaged in wrongdoing. Bell failed to note that Bacon's statement was taken from a memo written by Bacon to fellow branch office manager Steve Bralove about their banking activities in Washington, D.C., not about the activities in Alexandria, Virginia. While his statement obviously expresses Bacon's belief about Hutton's firmwide policy, and other evidence, including Bacon's own admission before our Subcommittee, suggests that the statement was descriptive of his Alexandria practices, it is careless at best for Bell to so attribute the quote.

Furthermore, it is beyond belief that Bell exonerated the Washington, D.C. office. That office was responsible for 97 counts in the Information, and for overdraft checks totalling approximately $436 million, and the Bacon admissions relied upon by Bell were most specifically applicable to that office, rather than to Alexandria.

<u>BELL RESPONSE</u>:

Our charter, as stated in the May 28, 1985 letter from Robert Fomon, was to focus on individual responsibility for wrongdoing. The standard we applied was that "no reasonable person could have believed that this conduct was proper." The counts of the Information were only used to identify branches that <u>might</u> have engaged in wrongdoing. The counts were not conclusive evidence of individual responsibility for wrongdoing.

The quote concerning 55 offices is taken out of context; we exonerated 69 branches that were identified as having "possibly engaged in overdrafting." (See page 72 of The Hutton Report.) I have not added the total counts of the Information for these branches. We found insufficient evidence of any individual responsibility for wrongdoing at the 69 branches.

As to any claim that we did not deal with 4 branches and 6 regions that represented 176 counts in the Information, this is not an accurate statement. All Hutton regions were discussed in pages 72-76 of The Hutton Report. The Staff Analysis does not identify the 4 branches that were allegedly omitted. Our analysis of the counts, however, indicates that the only counts not discussed in The Hutton Report that relate to possible branches identified in the Information were N61, N93 and A32. N61 and N93 are no longer in existence and A32 was not a retail branch but was an account in New York for Corporate Executive Services.

We interviewed Perry Bacon on two occasions. In both interviews he admitted that he had exceeded the drawdown formula. Our investigation focused on individual responsibility and Perry Bacon admitted overdrafting at the Alexandria, Virginia branch (C20) and the Washington, D.C. Eye Street branch (C18). There was no evidence that any other individual participated in wrongdoing at C18. In retrospect, it would have been appropriate to leave C18 off the exoneration list (Exhibit 16 to the Appendix), given the admissions of Mr. Bacon.

THE STATE PROCEEDINGS AND THE PEARCE SUIT:

We have obtained the orders of both Virginia and Georgia. We also know that New York has prohibited Hutton from engaging in remote disbursement. Just last week, Connecticut issued its findings, after holding extensive evidentiary hearings. The Bell report was relied on by Connecticut and was the basis for the Virginia and Georgia decisions. In short, Hutton is using both Bell and his report extensively in its negotiations with the states. Before any of the states acted, Bell and his team were invited to the annual meeting of the North American Security Administrators in Calgary, Canada and given a prominent role in the proceedings.

GEORGIA:

o According to the Georgia opinion, Georgia closely monitored and reviewed the progress, depth, and extent of the "independent investigation as to how the practices occurred."

o The Commissioner found that "the Bell investigation was an independent investigation, and that Hutton provided a clear written charter to create a process by which the investigation would be conducted."

o The Georgia opinion states, "According to the Bell report, no count in the Information was intended to be based upon the proper use of Hutton's drawdown work sheet." Therefore, it follows that Bell must have concluded that all counts must have represented improper usage. However, the order further states, "The Georgia branches did not engage in excessive overdrafting. This finding is consistent with the Bell report, which exonerated each of Hutton's Georgia branches." Neither Bell nor the opinion mentions that count # 2000 of the Information represents a BRC deposited by the Atlanta branch into Citizens and Southern Bank.

VIRGINIA:

o Again, the Bell investigation and report formed the basis for Virginia's findings and order.

o Hutton agreed that five BOMs (excluding Bacon) cited by Bell would be removed from management and supervisory positions and that they would be: 1) restricted to sales activities for 60 months; 2) prohibited from acting in management and supervisory positions for 60 months; and 3) subjected to review of all transactions effected for 24 months. In addition, their customers will be questioned periodically by Hutton about how their accounts are being handled. Incidentally, none of the five BOMs worked in Virginia, yet Hutton was permitted to "trade" them for its license.

o In particular, Hutton is to formally indicate to the Commission that Perry Bacon was permitted to resign on account of this activities that, in part, resulted in the plea agreement.

CONNECTICUT:

o Branch Manager Robert Clark had his broker-dealer license suspended for six months.

o Hutton paid a $350,000 fine to the State; $150,000 to cover the costs of its investigation and the rest to be donated to Connecticut charities.

o Hutton is prohibited from signing up new customers in Connecticut for two weeks, beginning February 18, and is on probation for one year.

o Hutton must write letters of censure to its officials who did not properly supervise its cash management operations.

o Hutton must tell its Connecticut customers that they can receive payments with local checks.

BELL RESPONSE:

I was not employed by Hutton to negotiate any settlements with the state securities regulators. I did meet with the Executive Committee of the North American Securities Administrators Association in June of 1985 in Atlanta and agreed to appear at the annual conference in Calgary. I spoke at the annual conference and answered questions about the investigation.

After that meeting, we made available, on request, to the state securities regulators packages of documents relating to Hutton activities in their respective states and a computerized summary of our investigation in their respective states. In addition, we furnished attorneys to the state securities regulators in West Virginia, Connecticut and Georgia to provide information on Hutton's activities.

We did not conclude that all counts of the Information represented "improper usage." Moreover, count 2,000 is the only count that references an Atlanta office, and it lists a $262,000 branch reimbursement check written September 9, 1981 on Chemical Bank by R95, an Atlanta office account. An investigation of this count did not indicate that any individual at R95 had engaged in excessive overdrafting. As noted in Exhibit 16 of the Appendix to The Hutton Report, R95 was listed in a count in the Information, but R57 and R93, two other Atlanta offices, were not listed in any count in the Information and did not meet any criteria for suspicious overdrafting or chaining.

JOHN PEARCE V. E.F. HUTTON AND GRIFFIN BELL:

Pearce charges in his suit that the Bell report contains the following false statements:

o Pearce engaged in the practice of chaining, and the practice was a "deviation from Hutton's normal drawdown structure."

o Pearce was responsible for creating a "St. Louis/Bethesda/ Seattle chain."

o Pearce was responsible for creating the "only chain identified that was initiated and administered at the branch and not at the regional level."

o Pearce acted in such a manner that "no reasonable person could have believed that this conduct was proper."

o Pearce "actually engaged in wrongdoing."

o Pearce was a "moving force in improprieties."

o Pearce engaged in activity "so aggressive and egregious as to warrant sanctions."

Pearce also claims that Bell made these and other false statements at the press conference he held in Washington when he released his report.

BELL RESPONSE:

Because the Pearce dispute is the subject of pending litigation in the United States District Court for the District of Columbia, in a case styled John M. Pearce v. The E.F. Hutton Group Inc. and Griffin B. Bell, Civil Action No. 86-0008, I will not respond to the allegations made by Mr. Pearce, and instead attach, as Exhibit 4, a copy of the Answer filed on my behalf in that suit.

RESPONSE OF GRIFFIN B. BELL
TO CONGRESSMAN WILLIAM J. HUGHES'
STAFF ANALYSIS OF "THE HUTTON REPORT"

THE HUTTON REPORT: Results of the Investigation of the Regions and Branches where the Transactions to which Hutton Pleaded Guilty Occurred

The investigation used various criteria and analyses to identify branches that possibly engaged in excessive overdrafting and chaining. Furthermore, because branches in each domestic region were identified for investigation of excessive overdrafting, each region was investigated for this abuse also. The results, when related to the 1900 counts to which Hutton pleaded guilty, raise more questions--especially about the investigation--than they answer.

> COMMENT: Excluding the branches identified in the Information counts to which Hutton pleaded guilty, the investigative criteria used by Bell ultimately identified only one branch--Bakersfield, California--where Bell found that excessive overdrafting occurred. Furthermore, Bell failed to find anyone responsible because the branch claimed the Regional Interest Specialist instructed the branch to overdraft, the Specialist declined to be interviewed, and other regional personnel contacted denied giving such instructions.
>
> Additionally, the Information identified 113 offices that engaged in excessive overdrafting to which Hutton pleaded guilty. Bell failed not only to find someone responsible at 93 of these offices, he even failed to find excessive overdrafting.
>
> Twenty-eight (28) offices representing 168 counts and $128 million were exonerated by Bell "[b]ased on the available financial documents and interviews of branch personnel. . . ."
>
> Fifty-five (55) offices representing 656 counts and $1.215 billion were exonerated by Bell because "the personnel at these branches denied that they overdrafted in amounts

> greater than that required by the drawdown formula and worksheet. In the absence of evidence sufficient to establish that these branches engaged in excessive overdrafting . . . they also should be exonerated." One of these branches--Washington (Eye Street), D.C.--was responsible for ninety-seven (97) counts and $436 million in transactions.
>
> Ten (10) offices--four (4) branches and six (6) regions--representing 176 counts and $623 million were not identified in The Hutton Report.
>
> *See* chart *infra*.

BELL RESPONSE:

The results of our investigation do not raise more questions than they answer. My staff of 15 lawyers conducted more than 300 personal interviews, including interviews with former and present Hutton employees from every level of the company. We investigated each chain identified by the Department of Justice and interviewed employees in 141 Hutton branches in 43 states with regard to excessive overdrafting. We also reviewed approximately 11,000 nonfinancial documents consisting of approximately 40,000 pages of memoranda, correspondence, reports and notes. In addition, we reviewed thousands of bank statements, cash receipts blotters, ledgers and other financial documents.

The methodologies and criteria used to identify branches that may have engaged in wrongdoing are discussed on pages 39-45 of The Hutton Report. An additional factor was being listed in a count of the Information. Bakersfield, California (L21) was the only branch not listed in a count of the Information that we confirmed had engaged in excessive overdrafting. The former branch cashier at Bakersfield, who left Hutton's employment in May 1984, stated that she was directed by Mark Willets, the Regional Interest Specialist, to add a set dollar amount to the daily drawdown. There was no evidence that any other Hutton employee at the Bakersfield branch had directed the branch cashier to exceed the drawdown formula.

The focus of our investigation was to identify individuals who had engaged in wrongdoing. We used different criteria than the Department of Justice used for the counts of the

Information.[1] We conducted personal interviews at 141 branches in 43 states and did not find sufficient evidence of individual wrongdoing at the branches that were exonerated. In retrospect, it would have been appropriate to leave C18 off the exoneration list (Exhibit 16 to the Appendix) given the admissions of Mr. Bacon.

The Hutton offices that were allegedly omitted from The Hutton Report were not identified by the Hughes Staff. Our analysis reveals that the only Hutton offices not discussed in The Hutton Report that were listed in a count of the Information were N61, N93 and A32. A32 was not a retail branch account, but was an account in New York for Corporate Executive Services. N61 was a branch in Houston, Texas that is no longer in existence. We investigated each of the nine domestic region offices of Hutton. The only region not investigated was the international region. This region was not accused of any wrongdoing. N93 was a branch in Greenway, Texas that is no longer in existence. All regional accounts were discussed on pages 72-76 of The Hutton Report.

THE HUTTON REPORT: Should Hutton have pleaded guilty to all counts of the Information?

Bell asserts that

> [i]n late fall of 1981 [Bill] Wilcox [the Louisville branch manager] negotiated a minimum fee service agreement with the First National Bank of Louisville. The bank closely analyzed the account and was fully aware of its status from that time until today. App. Exhibit 18 [attached]. This information raises serious questions about whether Hutton should have pleaded guilty to all counts of the Information. The government's theory of the prosecution of Hutton was that Hutton's abusive practices was [sic] a fraud on banks. In the case of Louisville, there obviously was no fraud (p. 71, n. 39).

> **COMMENT:** We have spoken with executives from the First National Bank of Louisville. They told us, first, that

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[1] These counts were compiled after Hutton had agreed to pay a two million dollar fine that required 2,000 counts to reach that dollar amount. The government showed Hutton's lawyers the list of the 2,000 counts for the first time at the plea hearing on May 2, 1985. We were advised by the Department of Justice that 1,900 of those counts were based on branch reimbursement checks that were written to cover negative collected bank balances of $500,000 or more.

> Hutton began overdrafting its account almost immediately after it was opened in September 1981. The bank discovered the overdrafting and promptly asked Wilcox to stop. Wilcox agreed, but the overdrafting continued and in fact increased in amount. Finally, bank representatives had to contact Tom Morley in New York, who also promised that it would stop. It continued until the bank threatened to close the account. The bank also demanded financial compensation for the overdrafting. Finally, in March of 1982, the overdrafting ceased. The bank was paid $21,737. in service charges and compensation.
>
> The Louisville bank representatives assert that they never agreed to let Hutton overdraft its account, and that they believe it is an unsound banking practice. They could perhaps be described as "acquiescing" in the overdrafting until Hutton stopped it. This was because Hutton had promised to accede to the bank's demand to cease the overdrafting immediately, and the bank was simply waiting for the "problem" to be straightened out. As noted above, when it was not, the bank threatened to close the account. Bell's assertion that there was no "fraud" on the Louisville bank because a minimum service fee requirement was negotiated in the late fall is misleading at best. The bank "negotiated" this arrangement in an attempt to compensate itself for the overdrafting.
>
> They were asked to write the attached letter to Bill Wilcox, who drafted it for them. They were not aware of the context in which the letter they wrote would be used, and would have made it more complete had they known.

BELL RESPONSE:

I am attaching to this response, as Exhibit 1, a copy of an internal bank memorandum dated November 13, 1981, which shows that the First National Bank of Louisville closely analyzed and monitored the Hutton account from the time it was opened in September of 1981. Also attached, as Exhibit 2, is a December 21, 1981 letter from an officer at the First National Bank to the assistant manager at the Hutton branch in Louisville, enclosing analyses for the months of October and November 1981. The letter also states that the Hutton account will be reviewed in January and July of each year to determine whether a service charge would be made on the average daily collected balance. These documents support a finding that the bank knew about the overdrafting by the Hutton branch in Louisville.

THE HUTTON REPORT: The number of chains

On page 38, Bell states that the Department of Justice identified 25 chains in its presentation to the court when Hutton pleaded guilty. In footnote 19, he notes that the Department "has stated that as many as 50 chains existed. The scope of our investigation does not permit us to confirm or dispute this claim." On page 56, Bell identifies the chains according to the categories listed above. He finds that 7 of the chains were created to generate clearing delays (category 1), but of this number, 2 were also motivated by the desire to improve availability of funds (category 2); 6 chains were created to improve availability of funds (category 2), including the 2 referred to above; and 4 chains were created for convenience purposes (category 3). Thus 10 chains were "justifiable," according to Bell's analysis, and 5 were not.

> COMMENT: First, why does Bell assert that DOJ's "claim" that there were as many as 50 chains is beyond the scope of his investigation? surely, the extent of the chaining is critical to a complete investigation.
>
> Second, Bell purports to review only the 25 chains identified by DOJ at the plea proceeding, but does not even do this. The number of chains he categorizes is only 15. There is no explanation anywhere of the other 10 chains.
>
> Third, as noted above, does dual motivation make a chain "justifiable?"

BELL RESPONSE:

The breakdown of 10 "justifiable" chains and 5 that were not, is incorrect. Exhibit 9 to the Appendix contains a list of 25 chains with over 77 branches that were identified by the Department of Justice. All 25 chains that were identified by the Department of Justice were investigated.[2] There is substantial overlapping between the chains, for example, Miami, Florida (R24) was identified with the Miami Beach chain, the Miami/Dallas/Atlanta chain and the Dallas chain. Southfield, Michigan, (F06) was identified with the F Region, two Dallas chains and the Old Kent chain. Page 56 of The Hutton Report discusses 15 of the 25 chains; a portion of the 10 remaining chains constituted subparts of the 15 chains that were discussed. Chains that were not identified on page 56 were either dealt with generally or we found that the chain was not created for an improper purpose. The Hutton Report does not state that a chain is justifiable because of "dual motivation."

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[2] Pages 37-38 of The Hutton Report states "[a] total of twenty-five (25) chains within the Hutton system were identified by the Department of Justice, and each of those chains was investigated."

Branches suspected of chaining that were identified in Exhibit 12 to the Appendix were not investigated unless they were identified in a count of the Information or met two criteria establishing a high correlation between above normal interest income profits and overdrafting banking practices at the branch. A discussion of this process is found on page 44 of The Hutton Report. We believed that it was not necessary to interview branches that may have been part of a chain but where there was no correlation between high interest income and BRC usage. First, if a branch was involved in a chain but did not benefit from unusually high interest profits, we considered it unlikely that the branch engaged in a chain created to generate interest income. Second, we had discovered from our investigation of the 25 chains that, with one exception, the chains were directed by the region.

Bell used a number of criteria to identify branches to be interviewed or investigated on the subject of chaining.

> The chains identified by the Department of Justice during the plea-taking on May 2, 1985, and those identified by Hutton's outside counsel and internal auditors were used to identify branches to be interviewed (p. 37).
>
> **COMMENT:** The Justice Department identified twenty-five (25) chains and indicated there may have been as many as fifty (50); using appendix 9 and appendix 12, we have found 23 branches identified as being in a chain by Hutton's outside counsel, the Department of Justice, or Hutton's internal auditors. Of the 123 branches identified, Bell has discussed the activities of only 56, fewer than half. There is no indication about whether or not these branches were "interviewed."

BELL RESPONSE:

Pages 43-44 of The Hutton Report state that branches suspected of chaining were not investigated unless they were identified in a count of the Information or met two criteria establishing a high correlation between above normal interest income profits and overdrafting banking practices at the branch.

HUTTON REPORT: Resolution of conflicting statements of witnesses

> **COMMENT:** In a number of instances, Bell cites conflicts between statements of various Hutton employees, but either makes no attempt to resolve those conflicts, or resolves them without any explanation of how he reached his conclusions. Often, those resolutions are in favor of the higher level

employee. Bell recommends sanctions against some of the branch and regional employees; ultimately, he must have concluded that the higher level employees who the branch and regional officers claimed approved their activities, but who denied it, were to be believed.

The following are examples:

1) Bell says that Aaron Hickey, the south central region's Interest Specialist, "established chains for the expressed purpose of creating clearing delays (p. 53)." "Hickey stated that Morley, Hutton's Money Mobilizer, said that chaining was permissible. Morley denied this (p. 53, n. 29)." Bell does not attempt to resolve the inconsistency.

2) John Pearce, the Bethesda, and then St. Louis, branch manager, "claims that the St. Louis/Bethesda drawdown was approved by Michael Wallace, the Central Regional Operations Manager. Wallace denies this assertion (p. 58)." No attempt is made to resolve the inconsistency.

3) Aaron Hickey "claims that Morley authorized him to increase the dollar amount of the calculated drawdown" in the South Central region. "Morley denies this (p. 60)." The inconsistency is not resolved.

4) Three midwest region branches, Grand Rapids, Michigan, Milwaukee, Wisconsin, and Minneapolis, Minnesota, claimed that the region instructed them to engaged in excessive overdrafting. Michael Goldstein, the midwest region's Operations Manager, denied this (p. 65). The inconsistency is not resolved, although Bell did include this discussion under the category "Excessive overdrafting that was directed, approved, or supervised by the region."

5) The Bakersfield, California branch claimed that Mark Willets, the Regional Interest Specialist, instructed the branch to engage in excessive overdrafting. Willets declined to be interviewed (p. 65). Although the inconsistency is not resolved, this discussion is included in the same category as # 4 above.

6) The Fresno, California branch manager, William Shaw, engaged in excessive overdrafting, claiming that the region approved the amount of the drawdowns. "The region" denied this (p. 71). Bell does not even state who in the region he spoke to. This discussion is included under the category "Excessive overdrafting directed by branch personnel."

7) Richard Genin, then Senior Vice President for Trading Operations, "disclaims any responsibilities for cash management and contends that this was the Money Mobilizer's area of control and supervision. Morley places Genin at a meeting in early December of 1981, after a weekly operations meeting at which Jensen and Morley told Epstein that there had been a problem with the Genessee Bank caused by overdrafting. Genin does not remember being there, and [Art] Jensen [the Atlantic Region Operations Manager] cannot remember Genin being there." The inconsistency is not resolved.

8) Perry Bacon, branch manager for the Alexandria and one of the Washington, D.C. offices, claims that Genin asked him how he made such large interest profits, that he explained his excessive overdrafting practices, and that Genin told Bacon he saw nothing wrong with those practices. Genin denies the incident (p. 89). The inconsistency is not resolved.

9) Tom Lillis, Vice President of Accounting Services, wrote a memo stating that a good cashier was worth as much as a good account executive in terms of generating interest income. Lillis says that the memo was a response to an inquiry by Robert Clark, the Hartford branch manager. Clark does not recall the request. "Later it developed that the Hartford office was engaged in serious overdrafting (p. 91)." Bell does not resolve the inconsistency.

10) Goldstein and Hickey "claim that their aggressive cash management practices were approved by personnel in the money management section in New York, New York. The head of this section [presumably Morley] has denied this claim. While approval from superiors can mitigate, it should not be allowed to exonerate these employees (p. 181)." Whether someone at corporate headquarters in fact approved the activities at issue here should have been a pivotal question of Bell's investigation. Ultimately, it is a question he never adequately resolves. Arguably, Bell implicitly concludes that the behavior of the regional employees was worse than that of the New York officials, given their respective punishments.

Bell recommended that Pearce, Bacon, and Shaw be fined a minimum of $25,000 and a maximum of $50,000, be assessed a proportional share of the restitution payment, be placed on company probation for a year, and receive letters of reprimand. He recommended that Hickey, Jensen, and Goldstein be suspended without pay for 30 days, and that they receive letters of reprimand (p. 179-81).

Morley, he recommended, should "be removed from any responsibility connected with money management or banking. We do not suggest that Morley be discharged because his defalcations was [sic] more than just his defalcations; they were a part of a failing in a management system (p. 175)."

Mark Willets no longer works for Hutton.

Genin was recommended for a letter of reprimand for failing in his responsibility to supervise the Regional Operations Managers who reported to him (p. 176).

No recommendation was made regarding Lillis.

BELL RESPONSE:

The Hutton Report did not attempt to resolve every conflicting statement when there was no corroborative evidence to support one individual's allegations against another individual. Our conclusions are found on pages 168-181 of The Hutton Report. A careful reading of the conclusions shows that I did not resolve conflicts in statements in favor of higher level employees. The recommendations made to Hutton regarding various individuals in several categories were based on a weighing of the evidence of wrongdoing and an evaluation of the relative responsibilities and knowledge of the individuals.

As to the examples provided by the Hughes Staff of unresolved conflicts:

1) *See* page 181 of The Hutton Report.

2) *See* Response to Statement, pages 4-5.

3) *See* page 181 of The Hutton Report.

4) *See* page 181 of The Hutton Report.

5) *See* Response to Highlights on pages 6 and 7.

6) Mr. Shaw identified two regional cashiers who denied approving the amount of the drawdowns.

7) *See* page 176 of The Hutton Report.

8) *See* page 176 of The Hutton Report.

9) There is no inconsistency between the Lillis memorandum emphasizing that the "relative worth of a branch cashier to an account executive" which Lillis claims was written after a call from Bob Clark in Hartford and Mr. Clark not recalling the request. The memorandum does not refer to "generating" interest profits. Mr. Lillis had no knowledge that Mr. Clark was exceeding the drawdown formula. (*See* pages 90-91 of The Hutton Report.) No recommendation was made for Mr. Lillis because there was no direct evidence that Mr. Lillis knew that branches were not following the drawdown formula.

10) One of the questions that I personally investigated was individual responsibility at corporate headquarters for Hutton's banking practices. There was no evidence that Mr. Morley approved Messrs. Goldstein and Hickey's aggressive cash management practices. Unfortunately, Kevin Mahoney, who was Mr. Morley's assistant during the relevant time period, died of lung cancer. Mr. Mahoney was alleged to have approved these practices. I did not conclude that the behavior of the regional employees was "worse" than that of the New York officials.

THE HUTTON REPORT: Scope of the Investigation

CEO Robert Fomon, in a letter to Bell dated May 28, 1985, set forth the scope of Bell's retention as follows:

> You are hereby requested to review the practices to which the Company pleaded, determine how those practices evolved, identify those individuals who bear personal responsibility (officers and employees) and make recommendations with respect to these individuals. . .
>
> It is our hope that you will proceed as expeditiously as possible, but take as long as is required thoroughly to complete your investigation. I pledge to you our full resources and cooperation and am directing all officers and employees to do the same. . . .

> (1) The Justice Department investigation covered the period from 1980 through 1982, and our investigation focused on conduct that occurred during this period (p.4).
>
> > **COMMENT:** The Justice Department investigation covered the period January 1, 1979 through April 1, 1984, and possibly later.

BELL RESPONSE:

The counts in the Information specifically refer to the time period July 1, 1980 through February 28, 1982; thus, the Department of Justice investigation "covered the period 1980 through 1982." It was our practice to obtain information post-1982 for insight into the 1980-1982 conduct.

> (2) The document review phase of our investigation was necessarily limited to the documents we received. We had no subpoena power or other mechanism to ensure access to all documents that may be relevant to the matters discussed in this report. We are not aware of any instance in which Hutton refused to provide relevant documents, with the exception of certain documents that Hutton and its counsel considered privileged. . .
>
> Hutton apparently failed to retain copies of certain documents produced by Hutton to the Department of Justice in the early phase of the grand jury investigation. These documents were not made available to us at all until August 30, 1985. Since that time, we have received copies of a limited number of these documents, and we have reviewed those that we have received (p.7).
>
> > **COMMENT:** Hutton's claim of privilege apparently was applied selectively against Bell, because Bell received documents on which Hutton is claiming privilege against the Subcommittee.

BELL RESPONSE:

We have no information regarding any documents that Hutton has claimed are privileged and protected from disclosure to the Hughes Subcommittee.

> (3) It was not possible . . . in the time allotted for the investigation to interview all relevant branches before commencing interviews at the regional level (p. 35).
>
> > **COMMENT:** Fomon directed Bell to "take as long as is required. . . ."

BELL RESPONSE:

We did not believe that it was necessary to interview all relevant branches before commencing interviews at the regional level because we had obtained sufficient information at the branches about regional activity before we interviewed at the regions. *See* page 35 of The Hutton Report.

> (4) Our investigation of branches was limited to an inquiry into the conduct that gave rise to Hutton's guilty plea (*i.e.*, chaining and excessive overdrafting), and our interviews were restricted to personnel employed during the relevant time at those branches that were either (1) identified as a branch suspected of having been involved in a chain, or (2) identified as a branch suspected of having engaged in excessive overdrafting (p. 36).
>
> > COMMENT: Apparently Bell did not look at the practices for which Hutton was enjoined.

BELL RESPONSE:

All the practices for which Hutton was enjoined were investigated. Obviously, the Hughes Staff has confused the chaining and excessive overdrafting at the branch level with the "criss-crossing" that occurred in New York. A discussion of "criss-crossing" is found on pages 100-115 of The Hutton Report.

> (5) The Department of Justice has stated that as many as 50 chains existed. The scope of our investigation does not permit us to confirm or dispute this claim. We did investigate a sufficient number of branches to reach valid conclusions concerning the purpose of chaining and who was responsible for it (p. 38).
>
> > COMMENT: To what limitation or scope does this refer? Without establishing the universe, his sampling is invalid.

BELL RESPONSE:

The universe was complete. We investigated all chains identified by the Department of Justice. This was not an investigation based on sampling. Pages 52-56 of The Hutton Report discuss the conclusions regarding the purpose of chaining and the individuals responsible for directing chaining. With one exception, we found that chaining was directed by the region.

> (6) Ledgers listing Chemical Bank BRCs used during the period between May 22, 1981 through November 30, 1981 were not available to us on a timely basis (p. 42).
>
> > COMMENT: Bell prepared his report without key information about a critical period.

BELL RESPONSE:

Although we would have liked to have had the Chemical Bank ledgers, we were able to obtain sufficient financial information about Hutton's banking activities from the cash receipts blotters, bank statements and reconciliation statements for the relevant Hutton accounts. Moreover, we had substantial documentation regarding the BRC accounts.

> (7) A significant portion of the branch financial documents that we requested were in the possession of the Department of Justice in Harrisburg, Pennsylvania, and were therefore not available for our use at the time of the interviews. Although branch personnel generally recalled and admitted their activities with regard to chaining, recollection with regard to excessive overdrafting was less vivid, even at branches suspected of this activity. The unavailability of all the relevant branch financial documents, therefore, hindered our investigation into excessive overdrafting (p. 46).
>
> COMMENT: This lack of documentation apparently did not, however, hinder Bell's rendering of his findings.

BELL RESPONSE:

This statement is a quote from footnote 24 at page 46 of The Hutton Report. The text on page 46 states that pertinent financial documentation was available to analyze whether a branch had engaged in excessive overdrafting.

> (8) Although the remaining sixty-nine (69) branches were identified as having possibly engaged in excessive overdrafting, the personnel at these branches denied that they overdrafted in amounts greater than that required by the drawdown formula and worksheet. In the absence of evidence sufficient to establish that these branches engaged in excessive overdrafting, we conclude that they also should be exonerated (p. 72).
>
> COMMENT: Fifty-five (55) of these sixty-nine (69) branches were represented in the 2000 counts to which Hutton pleaded guilty; the number of counts for each of these offices ranged from one (1) to ninety-seven (97) and the dollars ranged from $50,000 to $437,000,000. One office, Kansas City, met all eight (8) of Bell's criteria for having engaged in excessive overdrafting.

BELL RESPONSE:

In addition to being identified in a count of the Information, we used six criteria to identify branches that had engaged in excessive overdrafting. . We did not find sufficient evidence at any of the 69 branches of individual responsibility for excessive overdrafting and thus exonerated these branches. Kansas City, Missouri (C22) was a branch that met all criteria, including being listed in a count, but was exonerated based on insufficient evidence. The branch manager during the relevant time period was Ernie Dippel. Mr. Dippel was also the part-time regional sales manager and often used this account to draw down branch accounts into the region. Regional personnel claimed that the Kansas City account was overdrawn because it drew down the Hutton branch in Alexandria, Virginia (C20). We recommended that a letter of reprimand be placed in Mr. Dippel's personnel file because we concluded that Mr. Dippel "knew or should have known that branch managers within his region were excessively overdrafting their accounts." (See page 180 of The Hutton Report.)

THE HUTTON REPORT: The effect of excessive overdrafts on banks

Bell asserts that the estimates of restitution due the banks are exaggerated and that the Justice Department's "presumption that Hutton's banks were unwary victims is in many cases incorrect." Bell classifies the victim banks into four groups. First, there were banks -

> at which Hutton's deposit account was maintained in a manner satisfactory to the bank, both in terms of available funds overdrafts and bank compensation. This group includes those banks at which no excessive or consistent available funds overdrafts occurred. It also includes those banks at which available funds overdrafts were detected, either 1) on a daily basis or 2) during or at the end of a compensation period, and for which additional compensation was requested (p.127-8).

Bell asserts that "most banks with which Hutton maintained account relationships during 1980 to 1982 appear to fall into the foregoing group of satisfied banks."

> **COMMENT:** First, Bell does not identify those banks at which he alleges "no excessive or consistent available funds overdrafts occurred." Thus, there is no way to check how many such banks there were. Second, to denominate as "satisfied" those banks that discovered the excessive overdrafting and that extracted additional compensation from Hutton is inaccurate, to say the least. This would include banks such as the Genessee Country Bank in Batavia, NY and the United Penn Bank in Wilkes Barre, PA, both of which required Hutton to leave funds on deposit to compensate for the overdrafting. United Penn also received a $5000 compensating payment from Hutton. Both banks then closed Hutton's account. Bell would also include as a "satisfied" bank the First National Bank of Louisville, discussed infra. Even those banks that did not close Hutton's account but where Hutton engaged in excessive overdrafting can hardly be considered "satisfied." Many, many banks sought for weeks and sometimes months to force Hutton to stop this activity, often threatening to close the account until Hutton finally capitulated. Bell's failure to distinguish between these banks and those that were truly "satisfied" (if indeed there were any) substantially undermines the credibility of his analysis.

BELL RESPONSE:

This criticism is obviously one regarding the definition of a satisfied bank. We interviewed bank officers at over 60 banks and were told by a majority of these officers that they were satisfied with their banking relationships with Hutton.

Bell's second category is "banks that failed to detect either daily or consistent available funds overdrafts in Hutton's deposit account. This includes banks that could not make such determinations or, for whatever reason, did not. Bell concludes that few banks fall into this category.

> COMMENT: Bell fails to distinguish between "available" and "collected" funds. This is an important distinction, because Hutton sought situations where availability was the same or better than collectibility. While banks sometimes make funds available to the depositors whether or not those funds have been collected, it is the ability to determine the collected balances that enables banks to protect themselves against overdrafting or drawing on uncollected funds. Moreover, Bell ignores the fact that Hutton deliberately opened accounts in banks that it believed did not have the technical sophistication to determine collected balances. Again, he fails to identify these banks, precluding the reader from checking his assertion.

BELL RESPONSE:

We did not fail to distinguish between "available" and "collected" funds. *See*, *e.g.*, pages 19-21 of The Hutton Report. Page 19 states: "The depository bank determines when the funds represented by the check will be made available to the depositor. To understand this discussion it is necessary to understand the difference between `collected funds and available funds.'" We did not identify any banks in the report because we agreed to keep their identities confidential in exchange for their cooperation.

Bell's third category includes banks that did have the ability to determine available balances (*see* discussion above), but that did so inaccurately. He identifies at least one bank [sic] falls into this category, but no more than a "very few."

> COMMENT: Again, Bell's failure to identify these banks precludes the reader from checking his analysis. In addition, Bell creates an entire category consisting of one bank that apparently made an error in determining its balances and he seemingly blames that bank for Hutton's activities.

BELL RESPONSE:

We did not identify any banks in the report because we agreed to keep their identities confidential in exchange for their cooperation. We found one bank that made an error and believe that the Hughes Staff knows the identity of that bank.

Bell's fourth category "would include banks that knew of consistent available funds overdrafts in Hutton's deposit accounts and tolerated those overdrafts without complaint (p. 130)." However, Bell is aware of no bank that would fall into this category.

> **COMMENT:** Again, Bell provides no details to support his assertion, precluding the reader from verifying it.

BELL RESPONSE:

This criticism omits significant language. Footnote 98 at page 130 of The Hutton Report states that "we are aware of no bank that would fall into this category, other than certain banks with which Hutton maintained multiple accounts." This footnote further explains how a bank might determine the adequacy of bank compensation by analyzing all the accounts. Sufficient detail is provided, although the names of these banks are not provided.

THE HUTTON REPORT: Bank restitution program

Bell concludes that because only 26 banks had applied for restitution by the August 28 deadline, and an additional 74 notified Hutton of their intent to do so, "injury to the banks has been overestimated."

> **COMMENT:** Bell acknowledges that "a few banks are reluctant to assert claims in part because of the time and expense required to review or recreate records of transactions that occurred five years ago and in part because of a fear of possible adverse local or national publicity if the bank discovered that it had a claim against Hutton (p. 131, n. 100)." Again, Bell does not identify these banks, making verification of his claim, and of the number of such banks, impossible. Our indications are that there are quite a few such banks.
>
> Bell does not discuss the other options (such as a civil RICO suit, or other civil litigation) that banks might be pursuing in lieu of a claim for restitution. Neither does he acknowledge that some banks are dissatisfied with the terms of the restitution plan. First, it places the burden of analyzing the records and proving their damages on the injured banks, rather than on Hutton. Second, the plan requires the banks to offset any collected balances from July 1, 1980 through December 31, 1982 against any uncollected balances during that period. The criminal charges cover only the period from July 1, 1980 through February 28, 1982. Hutton allegedly stopped the illegal activities in early 1982, and began leaving large collected balances on deposit. By including the extra period of time between February 28 and December 31, 1982 in the restitution plan, the amount of the banks' damages is diluted.

BELL RESPONSE:

See Response to Highlights on pages 1-2.

THE HUTTON REPORT: The report is in the nature of a "public inquiry."

On page 3, Bell asserts that because Hutton decided to release the report to the SEC, the 50 state securities commissioners, the Congress, and the public, it "changed the investigation from an inquiry by Special Counsel at the request of the Board of Directors into something that would reasonably be considered a public inquiry."

> **COMMENT:** No one asked Hutton to retain Bell to write this report, and Hutton's decision to release it to the public does not obviate the fact that Hutton paid for the report and that Bell is Hutton's, not the public's, counsel.
>
> In addition, the Subcommittee requested supporting documents that Bell did not make public. The request was denied on the basis that the documents are "privileged." This is inconsistent with Bell's claims that his report is public.

BELL RESPONSE:

After Hutton pleaded guilty to 2,000 counts of mail and wire fraud and paid a $2 million fine on May 2, 1985, Hutton was the subject of extensive publicity and public discussion. The fact that I was retained by Hutton to act as special, independent counsel was also well publicized. Sometime in the summer of 1985, Hutton agreed to make copies of the report available to the SEC, as well as to state securities regulators. I recommended that The Hutton Report be made public.

Although I was retained by Hutton to conduct a special investigation, I was not Hutton's counsel in dealings with the state securities commissioners. I have never received a request from the House Subcommittee on Crime to make any documents public. At the request of Hutton I provided copies of my attorneys' interview notes and memoranda to the SEC.

THE HUTTON REPORT: "Due process" hearings

Bell claims that he conducted "interviews in the nature of due process hearings" with "individuals who bore some responsibility for the Hutton problem (p. 5)."

> **COMMENT:** Did Bell advise these people of their rights? Will their statements be turned over to the government if they show evidence of perjury or obstruction of justice? Bell does not provide any description of the kind of "due process" he provided. Since Bell is no longer a judge or Attorney

> General, it is presumptuous, to say the least, to say that his inquiry was conducted according to "due process" standards.

BELL RESPONSE:

I met with every individual who was suspected of having engaged in conduct that a reasonable person would have thought was improper. Each individual had the opportunity to be represented by counsel; only one individual, for whom discipline was recommended, was not represented by counsel. All individuals were presented with the allegations of wrongdoing that had been directed at them and were given an opportunity to respond and to identify individuals or documents that would exonerate their wrongdoing. At most of these meetings the individuals admitted their wrongdoing. Others identified persons whom they contended knew or condoned improper activity. Our investigators, moreover, interviewed witnesses identified at these hearings.

THE HUTTON REPORT: Was "chaining" ever "justifiable"?

Bell asserts that

> there were three purposes for chaining: (1) to generate clearing delays and thus increase interest profits by obtaining one day availability and two-day clearance on BRCs and DTCs; (2) to improve availability of funds; and (3) convenience. In our opinion, the latter two chaining purposes were justifiable from a business standpoint (p. 55).
>
> COMMENT: Bell does not even discuss how he arrived at this conclusion. He does not consider whether Hutton might have had a combination of motives for setting up the chains. For example, if Hutton's primary motivation was category one, to create float, but a secondary motivation was category three, convenience, Bell's criteria would apparently render this chain "justifiable." In addition, if the banks were unaware that they were part of a chain and/or were harmed by the activity, Hutton's motivation for it may be irrelevant.

BELL RESPONSE:

The conclusions concerning the purposes of chaining were obtained from personal interviews of Hutton employees and outside accountants in addition to an analysis of documentation on availability schedules. We determined that there could be more than one motivation for chaining, but decided that the convenience chains were not established to create float. The availability chains were not established to create float but were created to provide one day rather than two day availability. The banks had sufficient information to identify chaining activity because the bank would have to present checks for collection that were not from the same city in which the bank was located.

THE HUTTON REPORT: Who is entitled to the "float"?

On page 21, Bell asserts that

> [f]rom Hutton's perspective, someone other than Hutton has use of Hutton's funds during the period between the time Hutton deposits checks into its local bank accounts and the time the funds represented by those checks are made available to Hutton . . . Hutton, not unlike other corporate depositors, believes that it is entitled to share in the value of those funds while they remain in the process of collection in the payments systems.
>
> **COMMENT:** Bell says here that Hutton believes it is entitled to the benefits of the float on customer funds from the time customer checks are deposited into Hutton's account. Not even Hutton has made this assertion. If the float ever "belongs" to anyone, at that time it "belongs" to the customer, until the check clears and the funds become Hutton's.

BELL RESPONSE:

Page 21 of The Hutton Report specifically states that Hutton believes it is entitled to "share" in the value of these funds while they remain in the process of collection in the presentment system. The question of who "owns" the float is presently being debated and is unresolved.

THE HUTTON REPORT: Hutton's branch ledger balance

On page 31, Bell says that if the drawdown sheet operated "as designed," at the close of the business day, the branch office's ledger balance "would always be negative."

> **COMMENT:** This is not true in all cases. For example, if the branch did not have a deposit of customer receipts of good funds on a particular day, the ledger balance should be zero. A deposit late in the day after the branch has notified the region of the amount to be drawn down will result in a positive balance. Obviously, a correct understanding of the results obtained through use of the drawdown sheet is key to an adequate analysis of Hutton's activities.

BELL RESPONSE:

Obviously, the situations that would result in a positive balance or a balance of zero are rare. My attorneys were aware of how the drawdown sheet was to be applied and many hours of the investigation were devoted to the drawdown formula.

THE HUTTON REPORT: Recommendations

On page 10, Bell makes his final recommendations. The fifth recommendation is that "Hutton employ its independent accountants to review the adequacy of Hutton's system of internal accounting controls relating to the cash concentration system."

> **COMMENT:** This kind of review is supposed to be at the essence of any thorough financial audit. It is remarkable that Arthur Andersen has not conducted such reviews in the past, or at least required that Hutton's internal audit department do so before AA signed off on the financial statements.

BELL RESPONSE:

We were advised by Arthur Andersen that this review is not a part of the financial audit that was conducted by Arthur Andersen because Arthur Andersen was not required under general accounting standards to conduct such a review.

MEMO FOR CREDIT FILE

ADDRESS

E.F. HUTTON CO. INC.

ACCT. NO. 316-1050[illegible]

ASSIGNED CALL ______ PRIMARY OFFICER # ______ BRANCH ______

PROSPECT CALL ______ SECONDARY OFFICER # ______ ORIG. BY ______

PAGE NO. 1

11/13/81

Today I spoke with Tony Garcia who brought this account into our bank. Tony and Rick Westenhoffer know numerous individuals in the Louisville E.F. Hutton office.

Mr. Bill Wilcox is office manager while Mr. Randy Miles is assistant manager Debbie Miller is the Operations Manager who handles the bank statements and analysis letters.

We have scheduled a luncheon for Wednesday, November 25th, for the purpose of meeting with Messrs. Miles and Wilcox. Bill Schutz and I will attend representing the National Division. We are assuming primary account responsibility for the E.F. Hutton Co. relationship. This officer calls on Mr. Tom Morley, Cash Manager, in New York. I also call on the company's subsidiary, E.F. Hutton Credit Corp.

I have discussed the transfer of this account relationship from Tony Garcia to the National Division, New York office. Bill Schutz will be the Louisvi contact for the E.F. Hutton office.

Hutton has been running collected overdrafts. Since our bookkeeping system only reflects book balances, they have not been overdrawn. Our Collected Balance Report, however, reflects considerable collected balance overdrafts on a daily basis. We will track this information and will advise the compar on a semi annual basis of the shortfall which they will make up with an appropriate over-the-weekend Fed Funds deposit.

C.E. Mooser, Jr. C

CEM:mjb

cc: Tony Garcia/Main Office, First Floor
Bill Schutz/Nat. Bank. Div., 8th Floor

EXHIBIT 1

113 12 (Rev. 6/77)

FIRST NATIONAL BANK
OF LOUISVILLE

CHARLES E. MOOSER, JR.
Vice President

New York Representative Office
Suite 2401, 60 East 42nd Street, New York, New York 1016
Telephone (212) 661-093

December 21, 1981

Mr. Randell L. Miles
Assistant Manager
E.F. Hutton & Company, Inc.
100 Citizens Fidelity Plaza
5th & Main Streets
Louisville, Kentucky 40202

Dear Randy:

Enclosed please find analysis letters for your company account # 716-1952-4 for the months of October and November, 1981.

You will note that we are charging our earnings allowance plus 4% each month for the amount of the average daily deficit collected balance. This rate was 17.870% and 15.270, respectively, for October and November.

Each January and July I will review your account for the previous six month period. If there is a net service charge owing for the period, I will advise you by phone and letter of the amount. I then will advise you by phone of the amount and time of deposit required to make up the shortfall. You will then arrange to have collected funds wired to us for such amount and time required to be deposited.

We would prefer that you not move funds from your account by depository transfer check or ACH debit unless they are available funds. However, assuming that your account continues to have collected overdrafts, we will operate on the basis of proceedures outlined herein.

Please acknowledge your understanding of this proceedure by signing below and returning the original copy of this letter to me. I have enclosed a copy for your records.

I hope that all is well with you and that you have a very happy holiday season

Very truly yours,

Charles E. Mooser, Jr.
Vice President

Acknowledged: ______________________________ Date: ________________
Randell L. Miles, Assistant Manager

EXHIBIT 2

KING & SPALDING
2500 TRUST COMPANY TOWER
ATLANTA, GEORGIA 30303
404/572-4600

TELEX: 54-2817
TELECOPIER: 404 [illegible]
[illegible]
CABLE: TERMINUS

1730 PENNSYLVANIA AVENUE, N. W.
SUITE 1200
WASHINGTON, D. C. 20006
202/737-0500

September 6, 1985

The Honorable William J. Hughes
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Hughes:

It was good to see you briefly last evening.

I will be glad to do what I can to assist you in the Hutton matter. I noticed in the paper that you may call on me to testify, and this will serve to assure you that I will be glad to testify at your convenience.

All good wishes.

Sincerely yours,

Griffin Bell

Griffin B. Bell

GBB/jld-wdc
bcc: Terry Adamson
delivered by hand 9/6/85

EXHIBIT 3

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

JOHN M. PEARCE, Plaintiff, v. THE E.F. HUTTON GROUP, INC., *et al.*, Defendants.	Civil Action No. 86-0008 (J. Flannery)

ANSWER OF DEFENDANT GRIFFIN B. BELL

Defendant Griffin B. Bell, by counsel, as and for his Answer to the Complaint states as follows:

1. Paragraph 1 of the Complaint calls for a legal conclusion as to which no response is required.

2. Paragraph 2 of the Complaint calls for a legal conclusion as to which no response is required.

3. Mr. Bell presently lacks information sufficient to form a belief as to the truth of the allegations set forth in Paragraph 3 of the Complaint.

4. Mr. Bell admits that The E.F. Hutton Group, Inc. is a corporation organized under the laws of the State of Delaware and that it has offices located at One Battery Park Plaza in New York, New York.

5. Mr. Bell admits that E.F. Hutton & Company, Inc. is a wholly owned subsidiary of The E.F. Hutton Group, Inc. and that E.F. Hutton & Company, Inc. has offices and does business at various locations in the District of Columbia.

6. Mr. Bell admits the allegations set forth in Paragraph 6 of the Complaint.

7. Mr. Bell denies the allegations set forth in Paragraph 7 of the Complaint except that Mr. Bell states that he was retained as special, independent counsel for The E.F. Hutton

Group, Inc. and admits that Plaintiff has asserted claims in the Complaint based upon a written report which he, with the assistance of others, prepared and oral statements which he made at a press conference in the District of Columbia. Mr. Bell specifically denies having engaged in any wrongdoing.

8. Mr. Bell admits that Plaintiff was employed by E.F. Hutton & Company, Inc. as a branch manager in Bethesda, Maryland and St. Louis, Missouri, and that Plaintiff is currently an account executive in the State of Florida. Mr. Bell presently lacks information sufficient to form a belief as to the exact date on which Plaintiff commenced his employment with E.F. Hutton & Company, Inc. Mr. Bell presently lacks information sufficient to form a belief as to the truth of the allegation that Plaintiff was the branch manager in St. Louis "at the time of the events complained of in this action," except that Mr. Bell admits that Plaintiff was the branch manager in St. Louis at the time when he released The Hutton Report.

9. On information and belief, Mr. Bell admits that E.F. Hutton & Company, Inc. pled guilty on May 2, 1985 to 2,000 counts of mail and wire fraud as described more specifically in the Information filed against it at or about that time and that E.F. Hutton & Company, Inc. had, for some time, prior to May 2, 1985 been under investigation by a federal grand jury. Mr. Bell further admits, upon information and belief, that some employees of E.F. Hutton & Company, Inc. had been identified as targets during such investigation. Mr. Bell denies the remaining allegations set forth in Paragraph 9 of the Complaint.

10. On information and belief, Mr. Bell admits that Plaintiff received immunity from prosecution with respect to the matters as to which E.F. Hutton & Company, Inc. pled guilty. Mr. Bell presently lacks information sufficient to form a belief as to whether Plaintiff was a target of a federal grand jury investigation before receiving immunity.

11. Mr. Bell denies the allegations set forth in Paragraph 11 of the Complaint and further states that in the Information filed in the United States District Court for the Middle District of Pennsylvania there are numerous counts alleging violations of 18 U.S.C. § 1343 that relate to illegal conduct at E.F. Hutton branches in St. Louis, Missouri and Bethesda, Maryland during the time when Plaintiff was the branch manager at those locations.

12. Mr. Bell denies the allegations set forth in Paragraph 12 of the Complaint.

13. Mr. Bell admits that he was retained by the E.F. Hutton Group, Inc. to "review the practices to which the company pleaded, determine how those practices evolved, identify those individuals who bear personal responsibility (officers or employees) and make recommendations as to those individuals." Mr. Bell denies the remaining allegations set forth in Paragraph 13 of the Complaint.

14. Mr. Bell denies the allegations set forth in Paragraph 14 of the Complaint.

15. Mr. Bell denies the allegations set forth in Paragraph 15 of the Complaint, except that Mr. Bell presently lacks information sufficient to form a belief as to what specific knowledge The E.F. Hutton Group, Inc. had about whether Plaintiff was ever a target of the federal grand jury investigation.

16. Mr. Bell denies the allegations set forth in Paragraph 16 of the Complaint, except that Mr. Bell presently lacks information sufficient to form a belief as to what specific knowledge The E.F. Hutton Group, Inc. had as to whether Plaintiff violated 18 U.S.C. § 1341 or § 1343.

17. Mr. Bell denies the allegations set forth in Paragraph 17 of the Complaint, except that Mr. Bell presently lacks information sufficient to form a belief as to what specific knowledge The E.F. Hutton Group, Inc. had about Plaintiff's moral character and professional integrity.

18. Mr. Bell admits that in his capacity as special independent counsel for The E.F. Hutton Group, Inc. he appeared at a press conference at the National Press Club in the District of Columbia on September 5, 1985 after completion of the investigation which he conducted. Mr. Bell further admits that at that press conference he stated that he had conducted an investigation of various practices which led to the guilty plea made by E.F. Hutton & Company, Inc. Mr. Bell denies the remaining allegations set forth in Paragraph 18 of the Complaint.

19. Mr. Bell admits that several copies of The Hutton Report were distributed or made available at the press conference.

20. On information and belief, Mr. Bell admits that The E.F. Hutton Group, Inc. received The Hutton Report and approved the conclusions and recommendations discussed on pages 168-181 of The Hutton Report. Mr. Bell presently lacks information sufficient to form a belief as to the truth of the allegation that The Hutton Report was adopted and implemented by The E.F. Hutton Group, Inc.

21. Mr. Bell denies the allegations set forth in Paragraph 21 of the Complaint to the extent that those statements are quoted out of context; that which Mr. Bell wrote with respect to Plaintiff is as set forth in The Hutton Report which is to be considered in its entirety.

22. Mr. Bell denies that he made false statements about Plaintiff in The Hutton Report and denies the allegations set forth in Paragraph 22 of the Complaint.

23. Mr. Bell denies that he made false statements about Plaintiff and denies the allegations set forth in Paragraph 23 of the Complaint, except that Mr. Bell presently lacks information sufficient to form a belief as to what specific knowledge The E.F. Hutton Group, Inc. had with respect to the statements referred to in Paragraph 21 of the Complaint.

24. Mr. Bell denies the allegations set forth in Paragraph 24 of the Complaint.

25. Mr. Bell denies the allegations set forth in Paragraph 25 of the Complaint, except that Mr. Bell presently lacks information sufficient to form a belief as to what specific knowledge The E.F. Hutton Group, Inc. had with respect to the matters alleged in Paragraph 25 of the Complaint.

26. Mr. Bell presently lacks information sufficient to form a belief as to the truth of the allegations set forth in Paragraph 26 of the Complaint, but states further that Plaintiff's conduct may reflect adversely on Plaintiff's character and reputation.

27. Mr. Bell denies that what he stated at the press conference, as alleged in Paragraph 27 of the Complaint, is set forth verbatim, completely accurately, and in context. The quotations alleged in Paragraph 27 of the Complaint have been taken out of context; what Mr. Bell said at the press conference is to be considered in its entirety. Mr. Bell states further that the following exchange occurred at the press conference on September 5, 1985:

> QUESTION: Judge, Mr. Fomon was quoted recently as telling employees of your investigation that you found no criminal wrongdoing. You did find criminal wrongdoing but it wasn't at the top level?
>
> JUDGE BELL: Exactly.
>
> QUESTION: It was at the middle and lower levels?
>
> JUDGE BELL: That's exactly right.
>
> QUESTION: But it couldn't be prosecuted because the Justice Department immunized them?
>
> JUDGE BELL: No, no, that's not true. They didn't immunize all of them. Some they decided not to prosecute, at least two. And they did that as an operation of prosecutorial discretion. They decided not to prosecute somebody because they weren't very high, and I would've made the same judgment. I don't believe that you ought to prosecute -- if a company is doing something and you can prosecute the company and you can't find anybody at a rather high level to prosecute. I wouldn't prosecute the people in the middle or on the bottom, particularly where it's as confused as this situation, where it appears that they put

> in an overdraft system, albeit legal, and that people then abused that, the legal system. It was sort of taken for granted that overdrafting was proper.
>
> And then the question after that became, how much can we overdraft? How much can we get by with? That's what happened. And I don't find any fault with the Justice Department not picking out those people. It doesn't set well with the American public, and they lose confidence in the criminal justice system if you always end up and find some little person to charge where there's a big company involved.

Mr. Bell denies the remaining allegations set forth in Paragraph 27 of the Complaint.

28. Mr. Bell states that the quotations set forth in Paragraph 28 of the Complaint have been taken out of context and that that which he said at the September 5, 1985 press conference is to be considered in its entirety. Mr. Bell states further that the following exchange occurred at the press conference on September 5, 1985:

> QUESTION: Yeah, I have two questions.
>
> One is, do you feel that the civil rights of the people that you're fining have been violated? Because, you know, here you have a situation where people have not been convicted, have not had any chance for a trial and yet they are being, in fact, penalized and have been . . .
>
> JUDGE BELL: Well, you'll read about that in the report. I didn't like that at all myself, when I got to thinking about these people who were the subject matter of the counts, so far as I know, as near as I've been able to determine, they never had any chance to be heard. It was just a plea bargain between Hutton and the Department of Justice. That's why we didn't do more to these people. Excuse me, go ahead.
>
> QUESTION: But yet your report seems to still penalize them. I mean they are still being tagged as being convicted.
>
> JUDGE BELL: Well, they deserve to be penalized in some way for what they did. They should be penalized in some way. But I . . . If you'll read the report, we gave four reasons why we didn't do more to them.
>
> See, you start off thinking shouldn't these people be discharged? They're dealing with the public every day. Well, you start off with the fact that they've

> been . . . it's been three years since this happened. And as far as I know, they haven't been in jail or . . . I wouldn't say they've been living lives of rectitude, but I haven't heard anything bad about them. It's been three years.
>
> QUESTION: But you've got a situation where they now can't leave Hutton. I mean they're in a situation where they have to pay fifty thousand. How can you leave when you've been stigmatized by a report by a Congressional hearing?
>
> JUDGE BELL: If I was one of these six people, I wouldn't feel stigmatized. I would feel that I'd been punished. I would have remorse. I would pay my fine and I'd go to working harder to make up some money to make up for the fine.

Mr. Bell denies the remaining allegations set forth in Paragraph 28 of the Complaint.

29. Mr. Bell states that the quotations set forth in Paragraph 29 of the Complaint have been taken out of context and that which Mr. Bell said at the press conference is to be considered in its entirety. Mr. Bell states that the following exchange occurred at the press conference on September 5, 1985:

> QUESTION: As you say, the Justice Department identified a much, much larger number of chains and branches and the company pleaded guilty to the much larger charges.
>
> JUDGE BELL: Yeah.
>
> QUESTION: Why the discrepancy? Can you explain why you feel that those activities to which the company pleaded guilty were not improper?
>
> JUDGE BELL: Well, the only thing I can say about that is that we took every branch and every chain that the Justice Department accused, then we found some on our own. And if you'll read all those criteria, you'll see how we went about that. Then I sent these trial lawyers, who are experienced in assessing facts, and I sent them out to investigate, and then in many cases, they find that somebody else on a higher, say a regional level in chaining, every chain except one was fed up through the regions. These people had no way of knowing that it was improper. They were trying to take advantage of the inefficiencies in the payment system by catching, having delays.
>
> On the excessive overdrafts in single branches, where we ended up with 20 that

> we thought were wrong, we only finally concluded that seven branches, six people -- one of those people had two branches. He was at one place and moved to another -- engaged in excessive overbranches in both places. We . . . the standard we used -- which is that no person could have thought it was reasonable, which is -- I was trying to get something like a pretty close to a criminal prosecution standard, we decided they are the only ones that ought to be sanctioned.

Mr. Bell denies the remaining allegations set forth in Paragraph 29 of the Complaint.

30. Mr. Bell denies the allegations set forth in Paragraph 30 of the Complaint.

31. Mr. Bell denies that the quotations set forth in Paragraphs 27-29 of the Complaint are accurate, verbatim in their entirety, or properly put in context. Mr. Bell denies that he made false statements with respect to Plaintiff.

32. Mr. Bell denies that the quotations set forth in Paragraphs 27-29 of the Complaint are accurate, verbatim in their entirety, or properly put in context. Mr. Bell denies that he made false statements about Plaintiff and denies the allegations set forth in Paragraph 32 of the Complaint, except that Mr. Bell presently lacks information sufficient to form a belief as to the specific knowledge which The E.F. Hutton Group, Inc. had with respect to the statements referred to in Paragraphs 27 through 29 of the Complaint.

33. Mr. Bell denies that the quotations set forth in Paragraphs 27-29 of the Complaint are accurate, verbatim in their entirety, or properly put in context. Mr. Bell presently lacks information sufficient to form a belief as to whether all or a portion of that which he said at the press conference was permanently recorded by some or all of the media in attendance at the press conference.

34. Mr. Bell denies that the quotations set forth in Paragraphs 27-29 of the Complaint are accurate, verbatim in their entirety, or properly put in context. Mr. Bell denies the allegations set forth in Paragraph 34 of the Complaint.

35. Mr. Bell denies that the quotations set forth in Paragraphs 27-29 of the Complaint are accurate, verbatim in their entirety, or properly put in context. The allegations set forth in Paragraph 35 of the Complaint call for a legal conclusion as to which no response is required; but, insofar as they purport to be allegations of fact, they are denied.

36. Mr. Bell denies the allegations set forth in Paragraph 36 of the Complaint, except he admits that The E.F. Hutton Group, Inc. republished The Hutton Report.

37. Mr. Bell denies the allegations set forth in Paragraph 37 of the Complaint, except he admits that The E.F. Hutton Group, Inc. issued a press release.

38. Mr. Bell denies the allegations set forth in Paragraph 38 of the Complaint, except he admits that E.F. Hutton & Company, Inc. republished The Hutton Report.

39. Mr. Bell admits that in a letter dated November 22, 1985 an attorney representing Plaintiff requested a retraction and/or amendment and that the November 22, 1985 letter sets forth the request made on behalf of Plaintiff.

40. Mr. Bell admits that by letter dated December 3, 1985, through another attorney at King & Spalding, he refused Plaintiff's request for a retraction and/or amendment.

41. Mr. Bell presently lacks sufficient information to form a belief as to the truth of the allegations set forth in Paragraph 41 of the Complaint.

42. Mr. Bell presently lacks information sufficient to form a belief as to the truth of the allegations set forth in Paragraph 42 of the Complaint.

43. Mr. Bell presently lacks information sufficient to form a belief as to the truth of the allegations set forth in Paragraph 43 of the Complaint.

44. Mr. Bell presently lacks information sufficient to form a belief as to the truth of the allegations set forth in Paragraph 44 of the Complaint.

45. In response to the allegations set forth in Paragraph 45 of the Complaint, Mr. Bell restates and incorporates herein by reference his responses, as set forth above, to Paragraphs 8-44 of the Complaint.

46. Mr. Bell denies the allegations set forth in Paragraph 46 of the Complaint.

47. Mr. Bell denies the allegations set forth in Paragraph 47 of the Complaint.

48. Mr. Bell denies the allegations set forth in Paragraph 48 of the Complaint, except that he admits that King & Spalding was compensated for legal services which it rendered.

49. Mr. Bell presently lacks information sufficient as to form a belief as to the truth of the allegations set forth in Paragraph 49 of the Complaint.

50. Mr. Bell denies the allegations set forth in Paragraph 50 of the Complaint.

51. Mr. Bell further denies that he engaged in any wrongdoing with respect to Plaintiff or that Plaintiff is entitled to recover any amounts from him.

52. Except to the extent specifically admitted herein, Mr. Bell denies each allegation set forth in the Complaint.

FIRST DEFENSE

The Complaint fails to state a claim against Mr. Bell upon which relief can be granted.

SECOND DEFENSE

Plaintiff has waived all claims asserted by him in the Complaint against Mr. Bell and/or is estopped from pursuing any such claim against Mr. Bell.

THIRD DEFENSE

Plaintiff has previously compromised and/or released any and all claims against Defendants.

FOURTH DEFENSE

The statements complained of by Plaintiff are true and are not defamatory.

FIFTH DEFENSE

The statements complained of by Plaintiff reported on the conduct of a public figure and were published without actual malice, without knowledge of any falsehood, and without reckless disregard for the truth.

SIXTH DEFENSE

The statements complained of by Plaintiff reported on matters of public interest and concern and were published without actual malice, without knowledge of any falsehood, and without reckless disregard for the truth.

SEVENTH DEFENSE

The statements complained of by Plaintiff were published without fault or negligence.

EIGHTH DEFENSE

The statements complained of by Plaintiff constitute privileged comment on a matter of public concern.

NINTH DEFENSE

The statements complained of by Plaintiff constitute, in whole or in part, statements of opinion which are privileged.

TENTH DEFENSE

Publication of the statements by Defendant Bell about which Plaintiff complains was privileged absolutely or, in the alternative, conditionally.

WHEREFORE, Defendant Griffin B. Bell respectfully prays that the Complaint as against him be dismissed with prejudice, that he be awarded attorney's fees, expenses, and costs incurred in this matter, and that the Court award him such other and further relief as it deems to be just and proper.

Respectfully submitted,

Allen V. Farber

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Counsel for Defendant
Griffin B. Bell

Dated: July 10, 1986

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Answer of Defendant Griffin B. Bell was on this 10th day of July, 1986 hand delivered to:

Stephen G. Milliken, Esq.
Milliken, Van Susteren & Canan, P.C.
511 E Street, N.W.
Washington, D.C. 20001

John P. Coale, Esq.
Coale & Associates
1019 19th Street, N.W.
Suite 1040
Washington, D.C. 20036

and sent by Federal Express to:

John J. Walsh, Esq.
Michael G. Dolan, Esq.
Mark C. Ellenberg, Esq.
Cadwalader, Wickersham & Taft
100 Maiden Lane
New York, New York 10038

Allen V. Farber

ALLEN V. FARBER

Senator BIDEN. Judge, I have a series of fairly pedestrian questions, but I would like you to bear with me and go through it, if you would.

Judge you were on the court of appeals between 1961 and 1976; is that correct?

Mr. BELL. Yes, sir, that is correct.

Senator BIDEN. And you were Attorney General of the United States from 1977 to 1979?

Mr. BELL. That is correct.

Senator BIDEN. And you are now a Fellow of the American College of Trial Lawyers; is that correct?

Mr. BELL. I am the president.

Senator BIDEN. Mr. President.

And how many criminal prosecutions have you evaluated in one form or another over the years—hundreds, thousands?

Mr. BELL. Probably in the hundreds. I never was a prosecutor, but being Attorney General, you are into that area a lot, and you pass on whether you ought to bring prosecutions, oftentimes.

Senator BIDEN. And I suspect as a judge, you have made judgments.

Mr. BELL. Many times; I have probably been in 500, 600 criminal cases as a judge.

Senator BIDEN. I apologize for the interruptions here, Judge. I have a very bad cold and a sore throat, and I am sorry. By the way, would you like a cup of coffee, tea, or something?

Mr. BELL. No. I am enjoying this water.

Senator BIDEN. I was drinking that water, but it was making it worse.

E.F. Hutton engaged in three types of overdrafting. One was what is referred to as "target balance" overdrafting. A second was "gross overdrafting," a phrase used by Hutton and others——

Mr. BELL. "Excessive," I use; the same thing.

Senator BIDEN. "Excessive overdrafting."

And the third was "chaining." Now, you concluded——

Mr. BELL. And one other called "criss-crossing." And then there was some question about one called "encoding." "Encoding", we called it, where you disturb the numbers on the face of a check to delay it.

Senator BIDEN. And they engaged in that, also?

Mr. BELL. We found a few instances where that had happened, but there did not seem to be a pattern of it.

Senator BIDEN. You concluded, at least as to the excessive overdrafting and the chaining, that the conduct of the regional and branch personnel was, quote, "so improper that they could not under any reasonable standard have believed that it was proper"—is that correct?

Mr. BELL. Yes, that is the standard I used.

Senator BIDEN. Now, the Department of Justice prosecuted E.F. Hutton on the gross overdrafts and on the chaining as mail fraud—18 U.S.C. 1341 and wire fraud 18 U.S.C. 1343—involving a "scheme to defraud". And they used the mails or wires in the scheme to defraud.

Do you think that the Justice Department had a strong prosecutorial position as against the company under those two statutes?

Mr. **Bell**. I think it did as to a few counts. I think if they had brought a 2,000-count indictment that they could not have found a judge first who would have tried it—they would have probably severed perhaps 5 counts for trial and left the others. They were given concurrent sentences. So I think it was a 1- to 10-count case, but on those cases under the theory the Department had, I think they had a good case.

Senator **Biden**. Now, was this case, no matter whether it was 1, or 10, or 2,000 counts, was it in your view——

Mr. **Bell**. And I hasten to add, it is my understanding that they got up to 2,000 counts, trying to get up to $2 million in fines. So if they had prosecuted the case, I do not know what counts they would have had, how many.

Senator **Biden**. Would this case, however many counts it would have encompassed, have been a good RICO prosecution against the regional and branch personnel, the personnel that you talked about?

Mr. **Bell**. Well, I never have really given any thought to whether they should have brought a RICO until the last few days. I think you could have used the same counts, the same transactions, and had a RICO case. But the problem was they had given immunity to all these low-level people, so you would not have been prosecuting the low-level people, and you could have probably—there may have been some people who did not have immunity that you could have brought in under RICO. I just do not know. I have not really studied that out.

Senator **Biden**. It would seem to me at the time——

Mr. **Bell**. But logically, I think there would be no reason why you could not use the same mail fraud counts and wire fraud counts as the basis for a RICO.

Senator **Biden**. Well, that is what it seemed to me, quite frankly. The other thing that confused me was although I clearly—and I am not being solicitous—I clearly do not have either your standing in the law or knowledge of the law or experience in and of the law—it seemed a bit unusual to me—and I do not suggest there was any collusion, or I do not suggest there was any deliberate intention not to pursue one's job—but it seemed to me there was an excessive use of immunity at the outset which again—and I mean this sincerely—obviously it has nothing to do with you, nothing to do with your investigation, and I do not in any way question the intentions of Mr. Murray or Mr. Trott at the other end of the scale. But it did seem unusual that there were so many low-level grants of immunity, particularly without written proffers of testimony, so rapidly, in this case.

Now, do you think that the company, E.F. Hutton, had any other realistic alternative but to plead guilty to get this prosecution behind them and to avoid a long trial?

I am just trying to set the parameters here, what the options really were. I sit, and I listen, and I was quite frankly impressed with Mr. Foman's and with Mr. Ball's testimony, because they were fairly straightforward about the extent to which they thought the conduct was unethical, and they were fairly straightforward about their inability to withstand a long trial that as a practical matter, I do not see how E.F. Hutton could have afforded, if you want to be really blunt about it, I do not see how E.F. Hutton could have afforded anything other but to plea this thing out as quickly as they could.

Is it your assessment that they could have in fact sustained and been willing to sustain a long and protracted public trial?

Mr. **Bell**. Well, my judgment at the time would have been that they could not. Looking back on it now, I think they could have very well tried the case and gotten less publicity than they have gotten following the course they followed, because I think once they started dealing in terms of 2,000 felony counts, that you could not expect it not to carry a lot of publicity.

I think if they had plead guilty to a few counts, it probably would have gone away, to just a few.

Senator **Biden**. Please do not let me cut you off. This is a dialogue.

Mr. **Bell**. No, no. You are not cutting me off.

Senator **Biden**. The Department of Justice suggests to us that it had a problem under the Supreme Court case in 1982, the *Williams* case, and the *Frankel* case, on the "scheme to defraud" theory. And they came up with what I thought was a fairly ingenious and somewhat imaginative theory upon which to proceed.

But I was struck at the time also, after spending some time on this, as to why they had to go through that convoluted logic that they engaged in, which was, as I said, somewhat imaginative, had the Justice Department—do you think their prosecution problems could have successfully been avoided with the Frankel and Williams case had they reconceptualized this whole matter as a criminal conversion as opposed to a fraud? That is, there is a statute, 18 U.S.C. § 2314, which applies to criminal conversion.

Mr. **Bell**. Yes. I would just give an off-the-wall answer, because I have not really thought this out. But somebody would have to own the float. Who owned the float that he converted? You would have to find somebody to own it. Hutton generated the float themselves. The floats out there are sort of ethereal. It really belongs to you and me, but the banks get it in the first instance, and Hutton had figured out a way to get part of what the bank was getting.

But I do not know who owns the float, and that would be the conversion problem I would have. But I have not really thought through the conversion idea.

My problem is I have always thought that they had an ample number of counts at the Justice Department, however they brought them. And I think a "scheme to defraud", as a company-wide thing, would not have held together, because a lot of this was going only on a local level. What they did wrong was they put a system in that could be abused, and then they did not police the system. If anybody wanted to abuse it, they could, and not be caught.

Senator **Biden**. Well, it seems to me on the gross or excessive overdrafts and on the chaining, that I do not think there is much question about who owned the float in those two. We are not talking about zero sum balances. We are talking clearly about cases where the bank owned the excessive overdraft.

Mr. **Bell**. If you treated the bank as the owner of the float, you could have a conversion theory, and then you could defend it on the grounds of my question—you know, who owns the float; how does the bank get credit for getting this float, when it really belongs to the bank's customers.

But that would be a matter of defense.

Senator **Biden**. Well, again, the——

Mr. **Bell**. It would not be any open-and-shut case, but I would not want to argue it, whether it is a good theory or not. I had not really thought through it.

Senator **Biden**. In my view, had Justice conceptualized the prosecution as a conversion rather than a fraud, I think it would have had a very strong criminal case and a civil RICO case.

Do you agree that criminal and civil RICO was available? I think you said that in answer——

Mr. **Bell**. I think probably it would be, yes. I do not know why they would use civil RICO, because the Government did not lose anything, and they would not be getting any damages. They could get an injunction, I suppose, but they got an injunction, anyway. But certainly criminal RICO would be relevant.

Senator **Biden**. Well, I think you put your finger on it. Justice argues that the reason they did what they did is the only way they could get an injunction was to in fact plea bargain and in fact get E.F. Hutton to enjoin themselves from engaging in the activity——

Senator **Metzenbaum**. Mr. Chairman, could I interrupt for 1 minute?

Senator **Biden**. Yes.

Senator **Metzenbaum**. I am going to leave, because Senator Dole has asked me to come to the floor on another matter.

Is it the chairman's intention to proceed for a considerable period longer?

Senator **Biden**. Well, I have about another 14 or 15 questions for Mr. Bell.

Senator **Metzenbaum**. All right. I intend to come back, and I hope to be able to come back, and I think I will. I do have some questions.

Senator **Biden**. OK.

Senator **Metzenbaum**. Thank you.

Senator **Biden**. Back to RICO, had Justice successfully sought under criminal RICO for forfeiture of the proceeds of this illegal scam, which were estimated by the Department in their restitution agreement to be over $8 million, now, assuming they were able to prevail on the facts of the case, and they had moved under RICO, would we in fact under RICO have been able to have forfeiture up to $8 million, if we could prove that? Justice——

Mr. **Bell**. I do not know. You know, you have the world's leading expert on RICO sitting behind you up there, Professor Blakey, and I do not know that much about the RICO. But if you could forfeit that money—I do not know that. The Government has not lost any money; I know that. Now, the $8 million, if the Government could come in as a parens patriae and get the money for the banks, that would be one thing. I do not know if RICO goes that far.

Senator **Biden**. It does.

Mr. **Bell**. And I would not think it would be very fair for the Government to be forfeiting this money when the banks really were entitled to the money.

Senator BIDEN. Well, you have immobilized Professor Blakey with your compliment——

Mr. BELL. I hope not, but the parens patriae theory sort of interests me, if you could do that under the——

Senator BIDEN. I can answer the question, I think. You would not even have to proceed under that theory. The fact is that under RICO in a criminal prosecution, if there are ill-begotten gains, you can in fact have forfeiture of that amount.

Mr. BELL. I mean, could you get it back and redistribute it?

Senator BIDEN. Well, you do not have to redistribute it under that. (Conferring with staff.) You hold it, as Professor Blakey says, as a trustee for the victims.

Mr. BELL. Yes. Well, that would be a good thing to do. I heard Professor Blakey give a talk not long ago to the trial lawyers on RICO, and he convinced me that I needed to learn more about it.

Senator BIDEN. Judge, you are something else. You are good. Any guy who in 1976, when I went down to see him could convince me that bussing was a good idea, I know something is wrong, and you did it all with that southern accent, and I do not even speak southern.

Could Justice have secured under—well, without going through those questions—Justice could have secured, as we have established, under civil RICO, an injunction against the company for its illegal practices. Justice also testified that it believed that it had a venue problem under the mail and wire fraud prosecutions. They argued that the reason they did not move more aggressively is because they were locked into the Eastern District of Pennsylvania and so on whereas, with RICO, that in fact was not a problem, if they had proceeded on RICO. And Justice conducted its investigation by immunizing, as you mentioned earlier, lowerlevel people before it got testimony from them. That is the part that surprised me. Usually, it goes the other way. I mean, was that not your experience at Justice, that usually, the immunization came with the testimony, and not before?

Mr. BELL. Right.

Senator BIDEN. I mean, you had to figure what you were going to immunize; you had to have some rationale upon which the immunization was going to take place.

Mr. BELL. I think, the best I can remember it, they were getting immunity before they interviewed the witnesses.

Senator BIDEN. You got it, Judge. That is my recollection, too.

And Judge, I have, believe it or not, carefully studied your report and its appendix. You did not include in the published version sourcing footnotes to interviews or other statutes. Did you write up the interview, or did someone else?

Mr. BELL. We've got them in longhand. Every lawyer who did an interview made longhand notes, and we only have a few memoranda in the file. My experience has been if you take notes and convert them into a memorandum, you add something; it is not exactly like it was in the notes. And I did not want to have to defend a memorandum someday. So I told everyone just to keep their notes, and we have the notes. That is what I offered to the SEC and also to the States, is the lawyer with the notes. And they can ask the lawyer, then——

Senator **Biden**. So you do have a copy that reports the source, that has the source?

Mr. **Bell**. Oh, yes. We have all sorts of documents. In fact, we have a computer-indexed document file.

Senator **Biden**. Did you make this information available to the House committee, the source report and the interview reports?

Mr. **Bell**. They have never asked me for any information, and they declined to let me testify. And yesterday, Chairman Hughes told a reporter that I did not have any firsthand knowledge, which is a startling statement, since I did a lot of interviewing myself.

But for some reason, they do not want my information, but I did make it available to the SEC, and to the States.

Senator **Biden**. Would you be willing to make it available to this committee, the source report and the interview reports?

Mr. **Bell**. Do you mean the notes, that sort of thing?

Senator **Biden**. Yes.

Mr. **Bell**. I think so. I do not know of any reason why we would not. We asked the SEC not to give it out to the press, because you almost have to have the lawyer there to interpret the notes.

Senator **Biden**. Quite frankly, I am not sure we will have the time or the inclination to look at them, but I would like to know whether that is available.

Mr. **Bell**. Why don't I let you look at it and see what you want to do with it? At that time we can better decide. It is just a lot of raw notes.

Senator **Biden**. OK.

Mr. **Bell**. And we would be glad to let you have the documents, too, if you need those.

Senator **Biden**. Judge Bell, you concluded that the "injury to the banks" had been overestimated; is that correct?

Mr. **Bell**. I concluded that, and since this turned out to be so there, they are only paying out, I think, $3.5 million out of the $8 million. I called—I did not call; they called me—a man with Hutton this morning who was keeping up with that, and he asked me if I would like to have an update on the banks. And they are down to 50 bank claims now, and I think they have paid 33. And they still have not paid the others; they are negotiating in some way.

But anyway, it is less than the $8 million recommended. First, there was a lot of speculation in the newspapers that $8 million would not nearly cover the losses. And I sort of believed that, too, at first. And then, as time went by, and the claims started coming in, and I kept running across banks who I did not think would make a claim—we interviewed 63 banks, and a lot of the banks do a bank analysis, they do an analysis of accounts to see if they are making a lot of money, and a lot of them knew exactly what was going on, so I would not think they would make a claim, and they did not. And a lot of them would tell Hutton they were not making enough money on their account; they wanted larger balances and those sorts of things.

Senator **Biden**. Was there any reason——

Mr. **Bell**. But there were some banks that did not have the foggiest notion of what was going on.

Senator BIDEN. Is there any other reason you can think of that would make a bank disinclined to go after Hutton to file?

Mr. BELL. To file, yes. There are two reasons. I think I put them in the report. One is they would be embarrassed to admit they did not know what was going on. And the second one might be that they wanted to keep doing business with Hutton. Those are the two reasons—besides the reason that they did not have a claim.

Senator BIDEN. Did you calculate the total amount of injury to the banks? Was there any place in the report or in the notes where there was a calculation of the totality of the estimated injury that you referred to earlier, that the injury to the banks was overstated? Did you calculate anyplace what the total injury was?

Mr. BELL. No, no. I asked a lawyer the other day if it would be possible—and I will pose the same thing to the Committee—to see how much money Hutton made off of this operation, and then how much they spent. It would be interesting to know from the stockholders standpoint if they profitted any over the long run.

Senator BIDEN. When you say "spent", do you mean spent in the defense?

Mr. BELL. Yes; how much they made on these overdrafts' how much profit did Hutton make.

Senator BIDEN. Right. But then you said, "and then how much they spent."

Mr. BELL. Spent, yes, on paying the Government, the fines, and lawyers—no telling how much they paid lawyers.

Senator BIDEN. Yes, I understand.

Mr. BELL. But answering your question, I never made any study to see how much the banks could have suffered.

Senator BIDEN. Well, how would one go about determining what that figure would be? I mean, how would you begin to determine what the injury to the banks was in terms of independent calculation, not based on whether—because we acknowledge there may be myriad reasons why the bank would not come forward. Theoretically, it could be injured, not wish to come forward because it was embarrassed, and it would make the officers look bad in front of their stockholders; they may not wish to come forward because they want to keep the Hutton account; they may not wish to come forward because they were not injured.

So we cannot use, it seems to me——

Mr. BELL. Yes, it would be hard to do, and I think it would be expensive, but I think it probably could be done. There is a man up there in Hutton who runs the internal auditors—what is his name—Roberge, R-o-b-e-r-g-e—he knows more about the Hutton books than anybody I have ever run across. And we used to have a lot of trouble understanding the thing until we got to talking with him, and he can make sense out of the records.

For example, on some of the records they will have a general ledger account. Well, in 1981, that included a lot of different kinds of interest. In 1982, it changed that account, and they only included bank interest. But there are ways you could find out the answer to what you are talking about. That is what I said, you can go in and extract that information.

Senator BIDEN. The reason I ask——

Mr. **Bell**. And what it is is the value of the float for the days that Hutton used it.

Senator **Biden**. The reason I ask is it seems to me that one way to calculate it would be roughly, to take the checks drawn down on the zero balance account and deposited in any particular bank and subtract any amount related to a valid purpose—that is, target balance figures, or checks of customers that were returned for insufficient funds, and other things you could think of, but to take the two and you subtract the amount related to the valid purpose. The resulting sum, it would seem to me, would constitute the illicit or illegal float. And figure the period of time it was held by Hutton and the number of days and multiply it by the interest rate that could reasonably have been obtained had that money been let cut by the bank. And the resulting sum, it seems to me, should equal the interest converted by the failure to pay for the use of that float, which was the bank's money.

And I see your staff shaking their heads, no. And I am serious, I am trying to figure this out, so you are invited to the table, anyone on the staff, to explain to me why that answer, which the judge said is probably so, why we are both probably wrong, if any of you would like to do that.

It is kind of an important element in this, it seems to me.

Mr. **Bell**. Yes; I would not want to say that was right or wrong. But if I were the committee, I would ask Arthur Young & Co., who did the study of Hutton cash management. They might be able to tell you if that is the way to do it, or how to do it. They have got a man now working at Hutton as a treasurer who was with Arthur Young, and he is a cash management expert. And his name is Beehler, Paul Beehler is his name. He might be able to help.

Senator **Biden**. You suggested that the injury to the bank had been overestimated based on an analysis of the restitution program, which you suggest constitues, and I quote, "compelling evidence of the fact of overestimates." Is that correct? Do you want me to repeat that?

Mr. **Bell**. Yes, that is my idea of how to see if the banks were injured. That would be to check up to see how much money they asked for.

Senator **Biden**. Now, you know, of course, that banks have settled with E.F. Hutton outside the restitution program.

Mr. **Bell**. Oh, yes, yes, a number of them.

Senator **Biden**. And that banks have sued E.F. Hutton and have not participated in the program, because participation in the program limits them.

Mr. **Bell**. Yes; I did not know that, but I am not surprised.

Senator **Biden**. And that banks that acknowledge that they did not monitor accounts and pick up the scam opened themselves to criticism, which you mentioned before, which is one of the reasons why they might be embarrassed to move; and that banks had to pay their own way—accounting and legal expenses—to participate in the restitution program; and then in addition to that, to participate in the program, they had to waive any right that they had, including treble damages under civil RICO, that they could bring; and that banks who complained too loudly obviously ran the risk of losing the Hutton account that they might still have had—at least, it is a reasonable thing to suggest they might.

Mr. **Bell**. Right.

Senator **Biden**. And so the real criticism I have, Judge, of your report relates to the "compelling" statement that you make that a lot of people have seized on, that the fact that the damage and injury has been overestimated is proven by the fact that more banks have not sought restitution under the agreement.

Mr. **Bell**. Well, I would say that a bank that has got a claim and does not pursue it is in trouble with the stockholders. So there is some pressure out there that would make a bank file a claim. They cannot just give the stockholders' money away. So even if they are embarrassed, they had better file the claims.

I will tell you what I think, Senator, based on our investigation. I think that most banks—the majority of banks; I will not say most—knew exactly what was going on, and they were studying the account, and some of them told Hutton they did not want their business because they did not want all this overdrafting.

My experience—I have been a bank lawyer off and on nearly all of my career, and I have never seen a bank that needed a guardian. They understand money, and they are in the money business.

Senator **Biden**. You have never seen a bank that needed a what?

Mr. **Bell**. That needed a guardian.

Senator **Biden**. That needed a guardian.

Mr. **Bell**. Yes; they are in the money business. And in commercial accounts, they do these monthly analyses, periodically, studying an account, and it is not unusual for them to tell the corporation that they do not want their business anymore, or they are going to have to leave a greater compensating balance in. They want to make money.

Senator **Biden**. That is what I would think, too, quite frankly, and that is why I am a little surprised that we all—I should not say this so forcefully—I think the way it works is those same banks that are that judicious in looking out for their own interests are also the same banks that, if they conclude that they do not want a Hutton account because of the overdrafting, or that they are not making enough money over the Hutton account, that that usually is not only passed on by way of a letter or memorandum from the bank to Hutton, but that usually occurs that that is passed on from the bank president on the ninth tee with the chairman of the board of the company, too. I mean, those things do not go unspoken.

And the thing that has me concerned here is not whether or not you did anything to, quote, "cover up," but it seems to me the indicia of knowledge out there that somehow this never rose above the level of a single person, with the exception of one single person who was sort of that midlevel guy is not the way I know banking runs in Delaware, anyway. It is not the way its runs in Philadelphia, which I know a little bit about. It is a small community; people talk.

And I do not understand how anybody—that there was this total lack of knowledge. But maybe I just have not done it long enough.

Mr. **Bell**. Well, understand Morley is the man that dealt with the banks, and he is frequently characterized as being a "low-level" or a "middle-level." He was in fact a high-level.

Senator **Biden**. Well, he was making $30,000 or something, wasn't he? Where I come from, that is low level in banking.

Mr. **Bell**. They just do not pay, that is, a broker-dealer, anybody that is in that kind of business.

Senator **Biden**. Yes.

Mr. **Bell**. They have got to sell in a broker-dealer to make any money.

Senator **Biden**. I understand that. I think that is why people say, you know, basically, "low-level." There are a lot of vice presidents of banks making $25,000 a year.

Mr. **Bell**. Then we held the financial vice president and a director—and we did trace one settlement for the bank to him. But there were a number of settlements with banks. And I never did find anything, a file, where the banks cut them off, told them they did not want to do business with them. But I know where at least one bank is that told them.

Senator **Biden**. In light of the fact that certain banks have settled outside of the restitution program, certain have participated in it, others have reserved their rights, don't you think that it was a slight overstatement to suggest that the evidence is "compelling," that the fact that more have not moved is "compelling" evidence that there has been an overestimate?

I mean, what would you do if you were——

Mr. **Bell**. Well, I do not know about the word, "compelling." You know, it was a job to get this report written.

Senator **Biden**. No, look, I have been in a similar situation——

Mr. **Bell**. I would say I could change it to "strong"; the word, "strong," would suit me just fine.

Senator **Biden**. And by the way, I am not suggesting that I expect that you would have written every word, dot, and title. I mean, it is a little like me. I file a report on foreign policy from a trip to the Soviet Union, and it is 60 pages long, and I dictate the outlines to it, but I have got staff people who come in and dot the i's and cross the t's. So I am not trying to play a game of holding you to a single word. I am just trying to get a sense of the way this thing has been portrayed.

Judge Bell, you concluded in your report that "George Ball was a dominant figure in the company, and the other senior officers responded to him ex officio as a support officer." That was your quote. Is that correct? Was George Ball the dominant figure in the company that the other senior officials responded to ex officio?

Mr. **Bell**. Let me find that in the report.

Senator **Biden**. I think it is page 79, Judge.

Mr. **Bell** [perusing documents]. Yes. I wanted to read that and get it in my mind again. George Ball was the president, and he reported to Bob Foman, and so did a lot of other people on the same level, and did not report to Ball, which is a strange set-up. But he was so dominant that he was like the de facto President, and all these people respected him. And I think it was a great shock, maybe, to Hutton when he left.

Senator **Biden**. On page 95 of your report you also concluded that Mr. Ball, along with Thomas Morley, the money management person, were, quote, "leading advocates at the national level of increased interest income."

Mr. **Bell**. Right, right. Ball did almost everything by long- hand notes. He would write a note, and he had a secretary who interpreted his handwriting and typed out whatever he wrote in longhand. And he constantly exhorted people on the regional and branch levels to make more interest.

And I asked him about that—I interviewed him twice—I think and he said he was working the averages. He figured if he made everybody that was below average on the interest earnings come up to the average, the average would keep going up. That was his idea.

Senator **Biden**. Well, he was right.

Mr. **Bell**. No question that he was making it go up.

Senator **Biden**. You also concluded that, quote, "Most branch managers received as compensation a percentage, usually 10 percent of their branches' net profits"—that was on page 50—is that correct?

While you are looking for that, Judge, I am going to recess for 2 minutes. I have to take a phone call, so we will recess for 2 minutes.

Mr. **Bell**. Thank you.

[Pause.]

Senator **Biden**. All right.

Mr. **Bell**. Yes. You just asked me about the 10-percent commission.

Senator **Biden**. Yes, I did, Judge.

Mr. **Bell**. You said it was on page 50?

Senator **Biden**. I thought it was page 50 where the quote was, "Most branch managers"——

Mr. **Bell**. Yes, that is right. It is in the footnote on page 50; I see it.

Senator **Biden**. Yes. I am sorry. I should have indicated that.

Mr. **Bell**. That is it, the 10 percent. They are the main ones that got a commission on the interest.

Senator **Biden**. You also concluded that, quote, "Most of the senior officers understood that larger sums were being made under the overdraft policy." That is at page 83. Is that correct?

Mr. **Bell**. That is correct, yes.

Senator **Biden**. And what did you mean, or your staff mean, by—well, let me back up. You also concluded, nonetheless, that, "There was no substantial evidence"—on page 95 now—" that Ball was put on notice of any gap or lapse," to use your phrase, "in the accounting contracts."

Let me say that again, that you concluded on page 95 that notwithstanding that he was the leading advocate at the national level of increased income, and that most branch managers received their compensation as a percentage of their net profit, about 10 percent, and that most of the senior officers understood that larger sums were being made under the overdraft policy, that you concluded, though, that nonetheless, there was ". . . no substantial evidence that Ball was put on notice of any gap or lapse in the accounting contracts."

Mr. **Bell**. "Controls."

Senator **Biden**. Or "controls." I have written "contracts" here. I beg your pardon; a typo. ". . . in the accounting controls."

Mr. **Bell**. Well, let me tell you about Ball. You know, this investigation was very difficult, and you would keep getting information and you would always be focusing on people. And the first document I found, which bordered on being a "smoking gun", somebody gave to me on an elevator one day, a Hutton employee, and it was a document where Lillis wrote somebody, Morley, to say how important it was to have a good cashier, pointing to how much money they were making in somewhere—Hartford, I think.

Ball had written on there in longhand something exhorting people that this was a good idea and ought to be put into effect.

At that point I thought, well, Ball must have been mixed up in this some way or another; and that was a document that never had been produced, and nobody had ever seen one before, that we later found two other copies of that same document. One was in California, and one was somewhere else.

But then I found two other documents that implicated Ball to some extent—and I thought this was in his favor, though, not against him. There was a long memorandum about interest earnings, and it showed that in Alexandria, they were making—more than 100 percent of their total income was in interest. And he asked a question like, "Is this too aggressive?" and he sent it to Lynch. And I never could find if it was ever answered. That sounds like he was worried about it.

And then another thing that was very disconcerting was a memorandum where the secretary had transcribed one of his longhand notes which could not be read, "Was this legal interest?" And we had a great debate around the office on that; if he was asking was it legal interest, he must have known what illegal interest was.

We finally decided that in transcribing it, maybe he meant "ledger interest", or that it was a type of interest.

Months went by after the report came out. Ball himself testified in the House—no. They found an old shorthand pad, and they concluded from the shorthand symbol that the word was never "legal", but that it was "largely"; "Was this largely interest?"

Well, I did not have the benefit of that at the time. At the time I wrote the report, all I knew was "legal". But I concluded that was not enough evidence to hold him. That is all we had—plus the fact that he was exhorting people to make more interest. And that was his business, to make folks sell more and make more interest and make more money. That is why I came to that conclusion.

Senator **Biden**. Judge, you have been a judge for a long time, and you are practiced in the art, and obviously, and one of the reasons why you were hired, your reputation precedes you. It is one that is stellar. And you as a reasonable man reached the conclusion after you reviewed the evidence——

Mr. **Bell**. And interviewed Ball.

Senator **Biden** [continuing]. And interviewed Ball—that he was not knowledgeable of a scam.

Would you say that it was impossible for any reasonable man to reach any conclusion other than the one you reached?

Mr. **Bell**. No, not impossible, but it would be improbable.

Senator **Biden**. Improbable.

Mr. **Bell**. Improbable. But not impossible. It just—these are hard matters. You see, the Justice Department did not indict anyone on any middle or high level, and there was a lot in the newspapers about it, and I knew I had to be very careful not to overlook someone. And I looked at everyone who could have possibly had anything to do with it. It was like the last 2 or 3 days before I made my mind up on some of these people.

Senator **Biden**. It would seem to me that that might have created another—I do not mean to imply it was an illegal or unethical pressure—but it seems to me that here the Justice Department goes through and draws this conclusion that no one is really indictable, and you get to the point where you have to spend at least a couple days on some, deciding whether or not you believe that they were guilty of having done anything wrong. It would seem to me, were I in your spot, that I would be much more inclined to give the benefit of the doubt—and I truly am not—you have known me long enough to know what I am about to say is not designed to embarrass; I am just trying to get at——

Mr. **Bell**. Yes, I understand that.

Senator **Biden**. But it would seem to me that the instinct would be, well, look, Justice did not find anything to indict. I am not sure about this thing. It can make the case either way. The inclination would be, it would seem to me, to move against saying that there is responsibility.

Mr. **Bell**. No, that is not the way I reacted to it.

Senator **Biden**. Well, tell me how you reacted to it.

Mr. **Bell**. My idea was that it was a challenge to find something from somebody else, that maybe they did overlook somebody. And I was constantly trying to find their target lists—I would meet with them and try to get them to tell me things; sometimes they would and sometimes they would not, but——

Senator **Biden**. Well, let us talk about that for a second. What would have happened if you had concluded—know you do not know, but what do you think would have happened—if you had concluded in your report that, without naming a person, because I do not want to leave the wrong impression, that one of the two or three highest level officers of the company, if you concluded that in fact they had knowledge of the scam, and you wrote the report saying that John Doe had knowledge of this scam—you must have thought through what that would put in motion. What would have happened, then, in your mind?

Mr. **Bell**. Well, there would have been some more indictments. There would have been indictments on obstruction of justice.

Senator **Biden**. Well, could they have indicted?

Mr. **Bell**. Oh, yes. I do not know why they could not. They have got an investigation going right now of obstruction of justice because they did not give them all the records. If I had found someone, I would have had to tell the Justice Department about it, and I would also have told the congressional committees. I have never tried to—I always took the position, and I still do, that I could not cover up any kind of criminal activity.

Senator BIDEN. Oh, I agree with that, and I have no doubt in my mind——

Mr. BELL. And I have no doubt they could have indicted somebody else.

Senator BIDEN. Well, I was just trying to figure what would have happened. They have already had a plea bargaining, and the condition of the plea bargain as I understood it was no one, no individual, would be indicted—is that correct?

Mr. BELL. No. They have got some reservations in there. They have got reservations for perjury, false statements or perjury, and something else—what is the other reservation—well, there are reservations in there. I looked this up right at the beginning. And I will tell you when I looked it up was when that man gave me that document on the elevator. I began to think, "Well, I am going to get some more documents, and I am getting ready to get some more information." And I went back and checked it, and there are some reservations.

And as I say, they started an obstruction of justice investigation as soon as we found all these records that had not been turned over to the Department.

Senator BIDEN. Do you have any indication——

Mr. BELL. There were a number of boxes of records they found in a building.

Senator BIDEN. Do you have any indication from your extensive investigation as to who was responsible for, or why these records would not have been turned over?

Mr. BELL. Yes. We have a whole chapter on it in the book. It was the responsibility of the general counsel to collect the records. I had to do quite a bit of investigating to find out if it was the outside law firm or the inside Law Department, and I concluded—and this is undisputed—that the collection problem was that of the Law Department. They never turned the collection over to the outside lawyers. The problem came in the collection.

In these kinds of cases where you have got millions of documents, you have got to collect the documents, you have got to locate them, collect them, secure them, index them, and then be certain that they are available when you need them. And this is a big job, and something law firms are just learning how to do, and this law department of this company was not large enough to undertake that.

Senator BIDEN. Judge Bell, are you familiar with the "willful blindness instruction" in Federal court cases, "willful blindness instruction"? I can read it to you.

Mr. BELL. Read it to me; I do not believe I am.

Senator BIDEN. The instruction is—the "Federal Jury and Practice Instructions for Civil and Criminal Proceedings," the third edition.

Mr. BELL. That is just defining "willfulness"?

Senator BIDEN. Yes—well, let me read it for you. Section 1409, "Guilty Knowledge." It says, "The element of knowledge may be satisfied by inferences drawn from proof that a defendant deliberately closed his eyes to what would have otherwise have been obvious to him."

Mr. **Bell**. Yes, that is a well-known principle of law.

Senator **Biden**. "A finding beyond reasonable doubt of a conscious purpose to avoid enlightenment would permit the inference of knowledge. Stated another way, a defendant's knowledge of a fact may be inferred from willful blindness to the existence of the fact."

Now, let me raise the obvious question. We are constantly told in the first hearing that they had to provide scienter with regard to the upper-level people by proof that they had affirmative knowledge of the facts. And we have been in arguments with the Justice Department about this proposition that you can also find guilty knowledge under any of the statutes upon which they proceeded or could have proceeded, if in fact there is a finding that the defendant deliberately closed his eyes or a finding beyond a reasonable doubt of a conscious purpose to avoid enlightenment.

Mr. **Bell**. I think maybe—I have to look up the cases on that—the circumstances where you willfully close your eyes or deliberately close your eyes, it would seem to me you would have to first have some kind of notice, maybe a scintilla of notice, but some kind of notice, in order to prove that somebody has closed their eyes. You could not just show up at work and say, "Now, don't ever tell me anything bad."

Senator **Biden**. I am sorry, I did not hear the last part——

Mr. **Bell**. You would have to give me a circumstance. But I think that is a well-known——

Senator **Biden**. Well, a circumstance, for example, where——

Mr. **Bell**. It brings it down on proof.

Senator **Biden**. It is like that old—I will never forget when I was first here—it has been 14 years now that I have been in the Senate. But Bill Saxbee, one of your predecessors at the Justice Department during the Nixon years——

Mr. **Bell**. I knew him well.

Senator **Biden** [continuing]. After the Watergate hearing, when someone made a comment to him that, "Well, there is no proof that so-and-so knew," and he said, "Do you know what that reminds me of? That is like the piano player"—and he used the precise phrase; I will not—"like the piano player in the house of prostitution saying he did not understand what was going on upstairs."

Now, the circumstance that I can set up for you is where I set in motion a circumstance that my employees must follow and that I have reason to know that they could not possibly meet the targets that I set out for them without them in fact engaging in excessive, illegal overdrafts.

I mean, that is the dilemma that some of us come up against here.

Mr. **Bell**. Yes. Well, now they did not set that target. What they did may have been worse, but it was not a target. They would pick a place making a lot of money, and then they would tell everybody else to go and do likewise.

Senator **Biden**. Yes. Well, I kind of call that a target.

Mr. **Bell**. I guess that is a target, I guess that is a target.

Senator **Biden**. That is what I mean by a target. And I cannot believe anybody in the business as long as these people were in the business would not have known that there are significant disparities between profit margins, among profit margins, of various elements of the—based on geographic location and other factors.

I mean, it seems to me the only way he did not know is that he never asked. I mean, I do not know how—you know, it may be that he did not know. But it seems to me that at least someone up top would have asked. How would someone not ask how he was making all this money?

Mr. **Bell**. Well, Ball did ask. He said, "Is this not too aggressive?" He asked. That is the only time I found anybody asking.

Senator **Biden**. Yes, but what was the answer he got?

Mr. **Bell**. He never got an—we could not find an answer.

Senator **Biden**. Right. He said you did not get an answer.

Mr. **Bell**. He said he did not remember ever asking. I am looking in here for an exhibit. When I found this exhibit, I thought, well, everybody in this company is caught. It was a monthly report they send to the directors on interest earnings. Now, what exhibit is that?

Every month, this report would go out to the directors, and a lot of the top officers were directors. And it showed, if you study it, it would show some aberration on interest earnings. I wrote about this in the report, about this document.

It is exhibit 36. This is something that would go out to the directors every month. Knowing what I know now, you can look at that, and you can say, well, anybody should have been able to see that something was wrong. And I had a good deal of trouble dealing with this.

Senator **Biden**. How did you deal with it?

Mr. **Bell**. I called in Scott Pierce.

Senator **Biden**. Who is that?

Mr. **Bell**. Scott Pierce, P-i-e-r-c-e. He was the No. 2 man at Hutton, who was never implicated in any way in any of this. He was Ball's successor. And this had all stopped by that time.

And I said to him, "Look at this document." He looked at it, and I said, "You have been getting one of those every month, all back in the years when the interest earnings were too high."

And he said, "I never got anything like that. I have never seen one of these before."

And I had a time convincing him that he had been getting them. He said, "Well, you ought to see how many papers they send a director." The board met every 3 months, and they would get one of these every month.

I asked two or three other directors, and I finally concluded none of them ever studied them. And you would have to have a sequence of them to pick up the aberration.

When you study that out, that is pretty close to somebody having some knowledge.

Senator **Biden**. Yes, I would say. Let us just put in the record here what we are talking about here in terms of percentages.

The interest earnings, for example, in the Alexandria, VA, branch, were——

Mr. **Bell**. That is the one you always look at.

Senator **Biden**. Yes, well, it is a big one.

Mr. **Bell**. That was the one I looked at.

Senator **Biden**. Yes, sure. I mean, 76.7 percent; 109.7 percent; 117.8 percent; 13 percent; 167.4 percent; 25.8 precent. Now, I mean, that is kind of staggering.

Now, maybe they did not read this. But I mean, maybe not criminally, Judge, but as we move on from here——

Mr. **Bell**. Every director got this.

Senator **Biden**. Yes. What is a corporate director and a corporate officer's responsibility? I mean, let us forget what the law is. Let us talk about we have no reluctance of holding a drug dealer responsible for that kind of information that came in if we said we were trying to prove that he knew that they were dealing in coke. We would have no problem if you showed a bookie operation, and it was really a luncheonette, and there are profit statements of 109 percent gained on nonfood items. We would say, and you would say as a judge, I think, sitting there, "Now, wait a minute. The case is clear. All this money was made. These people say it was made here. I have got some low-level people here. The guy who owns it and who got the books every week and paid the checks, he says, 'Well, I did not know. I thought it was coming from Tastycakes.'"

We are very inclined—and this gets at the crux of my concern, not the concern of whether or not you have been fair or unfair, right or wrong, not whether the Justice Department intentionally or unintentionally covered anything up, but if that happened to anybody other than a corporate officer, we would say, "Wait a minute. Something has got to be wrong."

Mr. **Bell**. Let me just say I am in the position where I have got the only game in town; I am the only one that has done an investigation.

Senator **Biden**. Right. That is why we are talking to you. I love talking to you, but that is the major reason.

Mr. **Bell**. Yes. And I got a couple of things that the Justice Department could not get, because Foman, as a condition of my employment, ordered in writing everyone to cooperate, and if they did not cooperate, they would be gone. So I was able to get a lot of these things and then had to figure out what to do with them.

This was the hardest thing I had to deal with. All of these are adults. Experienced people would not have picked this up some way or another.

Senator **Biden**. Yes; and again, if you look at the—I do not have the yearly profit-and-loss statement in front of me, but there was a significant portion, I mean, it was a sizable amount of money that was made.

Mr. **Bell**. Oh, yes, on interest. In fact——

Senator **Biden**. On interest. And unless these guys and women thought they all of a sudden went into the banking business, it seems to me—I mean, I kind of thought that was what "willful blindness" was.

Do you have to show, for example—it is a rhetorical question—but do you have to show anything beyond that the report went to the directors, and it went to them two, three, four, five, six, seven, eight, nine times, and that the report said the following, and if they had looked at what it said, they would have reason to believe something was awry. I mean, what do we have to show to nail a corporate officer in this country? Do we have to have a picture taken of him reading a document, or does he have to walk out and say to his secretary, "By the way, look at this—17 percent this month. Those guys are really stealing it well this month." I mean, what do we have to have? I am not being facetious, Judge. I mean, it is the crux of our frustration here.

Mr. Bell. Oh, I understand that. I had to ask the same question. The first thing you would have to do is pick up an aberration. You would probably have to know what they made at Alexandria the month before, the month after. You would have to get a series of them.

Senator Biden. Yes, we got that. They had a series.

Mr. Bell. And they did; they had them every month.

Senator Biden. Yes.

Mr. Bell. And I finally decided that no reasonable director studies that much detail. I am on two boards——

Senator Biden. Well, when it is that much of their profits——

Mr. Bell. I am on two boards, and I do not study a lot of detail.

Senator Biden. Well, we are not just talking about the directors. This not only went to the directors. Isn't it reasonable to assume that it went to the officers, also?

Mr. Bell. Oh, yes, it did go—well, you understand on Hutton, nearly all the officers were on the board of directors.

Senator Biden. They are one and the same; they are on the board of directors, right.

Mr. Bell. Right. You see that in the report.

Senator Biden. I have been in the situation of being on the board of directors, and when I am not an officer, I spend a whole lot less time reading the report than on that corporation where I am a member of the board and also an officer. We all know how that works.

Let me put it this way, Judge. I think that the notion, with all due respect to my distinguished friend, as we say in this body, who testified earlier, that no reasonable man could conclude that somebody could have had knowledge or did have knowledge of what was going on upstairs while the piano was being played downstairs is different to accept.

It would seem to me that if you and I sat on a three-judge panel—and I have more respect for the Bench than to put me on it—but were the three of us on a panel, and you concluded, which you reasonably could—I admit, you reasonably could conclude that there was not willful, in this case, according to the instruction, willful blindness. It would be just as reasonable, though, for me—I doubt if I wrote a report in the dissent saying, "Chief Judge Bell, I believe there was willful blindness," I doubt whether you would not go and have coffee with me from then on because you thought I was stupid. You would probably acknowledge to me, "Well, I can see how you can arrive—I disagree with you, Joe, but I see how you can arrive at that."

Mr. Bell. Well, you could take the same approach on notice, have notice.

Senator Biden. Yes.

Mr. **Bell**. On page 170 of the report—I was trying to find it—I deal with this exhibit under the caption, "Directors", you will see that I finally concluded that, "The failure of the directors to notice such aberrations"—that is what I call Alexandria, the main one—"does not rise to the level that would require a sanction."

Senator **Biden**. Judge, I——

Mr. **Bell**. "A sanction."

Senator **Biden**. I understand. I am a——

Mr. **Bell**. But you can disagree with that. It is a matter of weighing the evidence.

Senator **Biden**. Yes, I agree. And I am in fact——

Mr. **Bell**. I am just trying to show you the strong points of——

Senator **Biden**. No, no. By the way, I am not questioning that. I am a fan. I have been. I make no bones about it. As a matter of fact, I expect you to help me when I run for President, if I ever do that. I am counting on you to be Attorney General again—that is a joke, for all of you out there. [Laughter.]

Senator **Biden**. But really and truly, it is not a joke. I am a fan. I am not in any way questioning your honesty or integrity.

What I am trying to establish here is that we had better get to that in fact, one of two things existed——

Mr. **Bell**. I thought your letter that you wrote me about what should be the standard against which you judge corporate officers, I think that is very thoughtful and provocative, and is probably one that has to be debated in this country.

Senator **Biden**. Well, I have a feeling it is going to be debated pretty thoroughly. By the way, we changed the law relating to, for example, us—we, Senators—you know, we collect millions of dollars in campaign funds. You do not have to prove I put the check in my pocket to put me in jail anymore. We passed the law. It is a standard much tighter than it is against corporate officials. Granted, we could argue the public trust is greater. I do not disagree with that.

But I would argue that (a) it would not have been unreasonable, it would not have been a malicious prosecution, if in fact the Justice Department had decided that it would roll the dice a little bit here and try to establish the case of willful blindness.

I have a few more questions, though, and I do not want to keep you. You are welcome to respond, if you would like.

Mr. **Bell**. No, no, no. That is fine. I just wanted to point that document out to you, because that is about the strongest evidence of notice I found.

Senator **Biden**. Well, you see, I put that together with the memoranda, I put that together with just the knowledge that something this sophisticated and this complicated does not get run, even though the day-to-day management is run by a $30,000-a-year guy or woman, you and I know that ain't where it is left; I do not care how you work it, it is not ultimately left there.

Let me tell you something. If those reports had come in—and I would be willing to stake my life—if those reports had come in, saying that in December 1981 and January and February of 1982, the interest earnings at the Alexandria branch were: 2.5 percent, 2.1 percent, 0, 3 percent, 1 percent, one-half of 1 percent, they would have noticed that——

Mr. **Bell**. Yes. Or minus.

Senator **Biden**. That is right, or minus. They would have noticed that sucker real quick, real quick. And I cannot believe if they would not notice it that in fact they are irresponsible corporate directors and officers. They are irresponsible if they would not. And so, we would be willing to say that—it is like those banks we talk about. We sit here and we say, "Look, the reason why some of those banks may not come forward is that they are embarrassed that they should have known, because people think them irresponsible."

Well, the same standard would have applied to Hutton, if they had been minus figures or down in the single digits.

Mr. **Bell**. I think they embarrass hard enough.

Senator **Biden**. Embarrassed? They would have been—which leads me to believe that they would—anyway, you understand where I am coming from, and let me move on now.

You concluded that Robert Foman was not responsible for failing to detect and terminate the improper overdrafting and other abusive practices, on page 171—that is the decision that you made.

Mr. **Bell**. That is where we get onto your letter.

Senator **Biden**. Yes. You suggest that he was entitled, quote, "to rely on the judgment of his subordinates," page 171, and that, quote, "it would be inconsistent with prudent corporate"—I guess "practice"; I have a blank here—"corporate and logic to hold Foman responsible for the default of any person." End of quote.

Now, do you mean that literally, the default of any person, or the default of any person in this case—let me finish, and then you can go back and talk all about this.

You also suggested that "prudent management recognize that some mechanism be established to make certain that abuses did not result from overdrafting."

Now, my question really is, should Foman be held responsible for the failure to put in place this mechanism that you term prudent?

Mr. **Bell**. That was the question.

Senator **Biden**. Yes. I am wondering what the answer is.

Mr. **Bell**. That was the question. So if we turn back in the report to page 166. This is a section here on "Standards of Corporate Governance", which is what your letter is directed at. There is a whole section on that, beginning on 156 and going through 167. Some of these are cases; some of them are statutes. One is from your State. And some of them are, in the American Law Institute's new work that they have been doing since 1980 entitled, "Standards of Corporate Governance".

And one is—and this is the one that applies to Mr. Foman—that you have a right to rely on others, but you are responsible for selecting good people. And that saved Mr. Foman.

When I examined Lynch's qualifications to be a financial—and I found he had been there a long time; he came out of a "Big 8" accounting firm—and all the other people that Foman had working for him, it seemed to me he was insulated. That is the heart of the letter you wrote. Can you insulate someone?

And I want to tell you this took a good deal of thinking, and my thinking might not be right, but I got to thinking about the President and something going wrong in the military. You come up the line, but you do not ever get up quite to the President, and you usually do not get to the Chairman of the Joint Chiefs; you do not get to the Chief of the Service. It cuts off somewhere.

And I got to wondering what is the basis for that. Why don't we just have a blanket, if it happens on your watch, you are responsible?

And then I came across this study, and it seemed to make some sense to me. And then I thought, well, there are other things that they do to a corporate officer. They can bring a shareholders derivative suit, for example, or the board can fire him or not give him a bonus. There are a lot of things that can happen to him besides prosecuting him. And I think maybe that gives some backing to this rule. That may not be the right way to do it, but it is something that addresses the Senate and the Congress, the whole idea of the standard to be applied.

Senator **Biden**. Let us just stick with the standard that is set out here, for example, on page 166, citing *McDonald* v. *American Leudec Petroleum*——

Mr. **Bell**. It is the next thing below that.

Senator **Biden**. And it says:

> Section 4.02 of the principles entitles an officer to rely on those selected to perform other duties in the corporation. This section provides: "In performing his studies and functions, a director or officer is entitled to rely upon information, opinions, reports, and statements, including financial statements and other data, or decisions and judgments prepared or presented or made and performed by . . .,"

Et cetera, and it goes down the list.

Now, in your example of the Presidency, what do you think would happen if in the Joint Chiefs of Staff, or in the military, it was clear that there was an illegal, covert operation going on, that although you can never prove that the President was involved in it, the press had in their hands a document, a letter, from the colonel in charge of the Defense Intelligence Establishment, addressed to the President, and had gone into the White House?

I suspect we would have something close to impeachment proceedings underway in this town.

Now, here you have—it seems to me we cannot have it both ways Judge—here you have the chief executive officer saying that, "We are not expected to be able to be held specifically accountable, because it is so big, it is so broad, and we are entitled to rely upon our reporting functionaries who come to us, and also the reports that are sent to us." And yet, we have established that we sent to them reports that any reasonable man or woman would say, "Hey, wait a minute. Something is awry here."

Mr. **Bell**. Yes.

Senator **Biden**. Now, how do we get there? Clearly—guarantee you, Judge, one of the only places I have more experience than you is in Government. I have been here longer than all but 26 people in the Senate. And I guarantee you if the defense establishment was involved in covert activity or scams, and it was not established it went to the Joint Chiefs, but you could find a letter into the White House or a report into the White House—it would be all over, Jack. It would be over.

Mr. **Bell**. Yes, that is right. But we do not have that there.

Senator **Biden**. But you do. You have reports going out.

Mr. **Bell**. We have that report which is—but you have got to be pretty sharp to pick that up from the report.

Senator **Biden**. Oh, gosh. Well, I do not want to argue with you, Judge, because—it seems to me, and I am not a big money manager, and I am not even a banker, but 107 percent earnings on your interest, that ain't bad. You do not have to be brilliant to figure out something is up.

Mr. **Bell**. It shocked me just to see it.

Senator **Biden**. Well, sure it shocked you. You are an intelligent man, and it shocked you.

Mr. **Bell**. Understand I am the man that found this document.

Senator **Biden**. No reasonable man, in my view, if, in fact, they read that report and knew the business, could conclude that there was legitimate interest being made. The only thing I could agree with you on and understand your judgment is that you cannot prove they knew it. But if in fact you had a picture of them reading the report, and you knew what it was, you would not have made the same recommendation, would you? Wouldn't that sucker be on the carpet? I mean, how could he not be?

Mr. **Bell**. Yes; this is more like the Defense Department not putting in the proper controls so they can find that the defense contractors are padding the accounts, or something like that. They did not have controls in this company. That is the fault of the management. That was what I was looking at. And then I decided that the next man below Foman was the man who should have been responsible for that.

Senator **Biden**. But if, as the Chief of Staff of the White House—and I will not continue to pursue this—there was memoranda coming from the defense contractor, outlining that you were charging $790 for toilet seats——

Mr. **Bell**. And you did not see it.

Senator **Biden**. Yes.

Mr. **Bell**. And you did not do anything about it.

Senator **Biden**. Yes.

Mr. **Bell**. Well, the question would be would you hold the President for that, or would you hold the Defense Secretary, or the Deputy, or just where would you cut it off?

Senator **Biden**. Well, I think you would hold whoever it was addressed to.

Mr. **Bell**. That is the question.

Senator **Biden**. Right.

Mr. **Bell**. That is the question posed in your letter. That is a hard question.

Senator **Biden**. Well, OK. Let me ask one last question. This will be the last question, period, then. I know you are going to miss being here.

Mr. **Bell**. Tell Senator Metzenbaum I will be glad to answer something in writing if he has got something.

Senator **Biden**. On April 22, as you mentioned earlier, I sent you the letter asking you to reflect on the contemporary soundness of the 19th century principle that an executive in a corporation had no duty to anticipate rather than react to wrongdoing by subordinates. And I ask that a copy of that letter appear in the hearing record at this point. And in light of the studies of corporate recidivism, do you think that principle ought to be held to control today, or do you think something else, or would you rather submit for the record an answer to the letter?

How would you like to do that?

[Document follows:]

[Not available at press time.]

Mr. **Bell**. I really did not know how to answer that, because there is such a thing as corporate recidivism—you named a company. But between the events, I think, that you described, they have probably got a whole different set of managers.

Now, I think it would be worth knowing what the Ethics Resource Center here in Washington is doing, how they put these ethics programs in, and they bring in people from business schools to lecture all of the employees on ethics; the CEO makes talks. And it is a remarkable thing that happens—all the employees' morale goes up. They want to be working for an honest, ethical company.

Senator **Biden**. They do not, you say?

Mr. **Bell**. They do. They want to be.

Senator **Biden**. They do.

Mr. **Bell**. And they are glad to know this is going on.

There is a man named Gary Edwards who runs the Ethics Resource Center, and they have got this going now in maybe 25 or 30 companies, and it is an approach that I think is good, and it is not unlike what you are talking about in the letter.

What is there about one company where they constantly violate the law? There is something in that culture that is wrong. And you are more interested in what to do about it, and I am coming from the other end, of what is causing it.

Senator **Biden**. Well, I do not think I can figure out what to do about it until I figure out what is causing it. But it seems to me it is pretty clear what is causing it.

Mr. **Bell**. Greed.

Senator **Biden**. Yes, plain, old-fashioned greed.

Mr. **Bell**. You know, the interesting thing is most of the people, in cases I have been in where somebody is accused of having done something wrong, most of the time, the employee did not get anything out of it. It is absolutely amazing how many of them will join in some sort of a misconduct, that is criminal or borders on being criminal, and did not get anything out of it; they think they are helping the company. Now, that is the culture, you see.

Senator **Biden**. Well, it is something that I hope the business community, to repeat myself from the last hearing, begins to think about——

Mr. **Bell**. That is right.

Senator **Biden** [continuing]. Because if they do not, I can assure them it will be legislated. It will be legislated in a way that may not be as conducive to the free enterprise system and the growth of the economy as it would otherwise be if they were to act.

Judge, I appreciate your time, and thanks for coming up.

Mr. **Bell**. Thank you. If you have anything else you want me to comment on, I would be glad to do it in writing.

Senator **Biden**. Thank you.

[Whereupon, at 4:25 p.m., the committee was adjourned.]

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